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A PRIMER OF TAXATION

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An Introduction to Public Finance

BY

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To

E. F. E.

WHO FIRST POINTED OUT
TO ME THE PATH OF
CITIZENSHIP

PREFACE

SOME apology is perhaps necessary for adding to the number of already existing books on Public Finance. My excuse is that most of them are either learned treatises or else popular works on some definite form of taxation or descriptive of the actual working of the Budget.

Questions of public expenditure and income are now involved in many important legislative acts and the financial policy of a government is becoming increasingly attended to by the electors; this is also equally true in the case of local finance. I have attempted in this little book to make a really interesting and simple account of the development and working of our taxing system. No pretence is made of completeness; my idea has been rather to cover the whole wide field of public finance in such a way as to suggest further study of any particular parts which may appeal to the reader.

I am particularly indebted to the economic writings of Profs. Bastable and Seligman and Mr. J. A. Hobson, and if I only succeed in making this an introduction to their treatises a great part of my purpose will be fulfilled. I would, however, have this work looked upon rather as an essay in a branch of citizenship than as an attempt at grappling with the problems of public finance. To be worthy of the responsibilities of citizenship a person must know a good many things about the working of the national institutions under which he lives and of these the Exchequer is quite one of the most important and one which must necessarily affect him. A reasoned and enlightened public opinion on matters connected with national and local finance is absolutely necessary if an intelligent interest is to be taken in the governance of our country.

I have to thank a number of friends for help and encouragement in the preparation of this book; particularly would I mention the Rev. Bede Jarrett, O.P., M.A., and Mr. T. W. Price, Warden of Holybrook House, Reading.

E. A. L.

CONTENTS

CHAPTER I

INTRODUCTION—PUBLIC EXPENDITURE

CHAPTER II

PUBLIC INCOME

CHAPTER III

THE THEORY OF TAXATION

CHAPTER IV

SOME IMPORTANT TAXES

CHAPTER V

THE FINANCE ACCOUNTS OF THE UNITED KINGDOM

CHAPTER VI

PUBLIC CREDIT

CHAPTER VII

LOCAL TAXATION

CHAPTER I

INTRODUCTION—PUBLIC EXPENDITURE

WHATEVER theory we hold of the State, public expenditure comes in somewhere. The most extreme individualist finds something for the State to do, and nowadays to do almost anything you must have money, and the government is no exception to this rule.

A number of writers have laid down definite rules as to whether the State should attempt any given activity; thus J. S. Mill distinguishes between the *necessary* and the *optional* functions of government, while a German economist, Roscher, divides public action under three heads—the *necessary*, the *useful*, and the *superfluous*. Mill's analysis is based on his general philosophical theory of utilitarianism and, as is often the case with other thinkers, he scarcely seems to recognize that the functions of government must change as the conditions of the governed develop.[1] However, such

[1] A good example of this is afforded by John Bright's denunciation of the Factory Act of 1847 as "one of the worst measures ever passed in the shape of an Act of the legislature"—so obsessed was he by the principle of non-interference by the State.

discussions belong rather to political science and we cannot go into them here. It must suffice for us to lay down as a definite principle that, as government is for the good of the governed, the true criterion of government expenditure is whether it will benefit the community as a whole. From that we can pass on to enumerate a number of heads under which we can classify the expenses of a modern State :—

1. The cost of defence and external security.
2. The cost of justice and internal security.
3. The cost of poor relief.
4. The cost of education.
5. Constitutional and administrative expenses.
6. Local expenditure.

We will consider very briefly each of these in turn. Under defence we must include the expenditure on the Navy, Army and Air Force, and the cost of what is called the peace establishment, or the expense of being prepared for war, is the normal part of this item. In 1775 our expenditure on the Navy and Army was about £4,000,000, in 1900 it was roughly £121,000,000, and the latest Budget (1921) votes for £95,000,000 for the Army, £80,000,000 for the Navy, and £16,000,000 for the Royal Air Force; when one realizes, too, that the National Debt has been built up chiefly by the cost of wars, it seems that whatever the moral, political and economic aspects of war may be, financially it looks appalling. As Adam Smith puts it, "The cost of defence grows gradually more and more expensive as the society advances in civilization," and to-day, as in 1776 (when his first work appeared), there seems to be no limit to the increase. Undoubtedly, with human nature what it is, expenditure for naval and military purposes is essential, but this must not blind us to the fact that much of that expenditure is economically unproductive.

The same applies for a large extent to the expenditure on justice. The rights of the individual as well as of the nation have to be secured, and this includes his legal and his bodily protection, the law courts and the police. We must distinguish the civil and the criminal courts. Although in some respects the evolution of the former may suggest that the parties concerned might be made to support the court to which they appeal, yet a weighty argument against this view is the possibility of corruption when rich suitors are concerned in a case. At any rate, it is recognized that the civil courts cannot be self-supporting, and the same thing holds good, of course, with the criminal courts. Whatever, too, may be our theory of punishment, some form or other of a penal system is necessary, and, as a fact, the humaner methods of to-day need much more money than did the prisons of a hundred years ago.

Since the dissolution of the monasteries the State has been looked upon as the proper agent to apply relief for the poor (including the orphan, the cripple and the insane), and the first Poor Law of 1601 has been followed by a number of other measures. The performance of this duty is, however, by no means easy, apart from the immediate financial aspect; no system of poor relief can be considered satisfactory which encourages the pauper to rely on the State for the supply of his needs—although the history of our poor laws shows that it was some time before people began to realize that this was the defect in the legislation. To-day, for us in England, we may include the old age pensions and the national health and unemployment insurance schemes under this head.

The public expenditure on education has been one of the latest items to be added to the budgets of most states.[1] Originally left to voluntary and religious institutions, education and culture have now been recognized as having a definite effect on the earning powers of an individual; primary education is compulsory, and State-aided secondary schools, technical colleges and universities have tended to remove some of the disabilities due to the "accident of birth"—although there still seems to be room for further developments.

Constitutional and administrative expenses include the expenditure on all the various departments of government—the legislature, e.g., the payment of the Members of Parliament, the executive, e.g., the payment of the Ministers of the Crown, and the civil service—and a large number of miscellaneous charges like the cost of keeping and inspecting an efficient system of weights and measures and maintaining ambassadors and consuls in foreign countries.

[1] Thus in England the first grant for education was in 1833. See Chapter VII.

Finally, we have in England the various grants made to local authorities to supplement the revenue obtained by them in local taxation.

There is one general feature of public expenditure that we may notice at this point. A comparison of the budget estimates of last year and, say, of twenty or fifty years ago will show that the expenses of the State are increasing. The same thing holds with almost every country—Roscher, indeed, lays it down very optimistically as being a law of progress; increasing demands on the modern State are made by society; the cost of war alone has increased enormously, while almost every year there is a further extension of administrative action. When, however, we are comparing our national expenditure to-day with what it was, say, fifty years ago, we must remember the depreciation in the value of money and the increase in population along with which the national income grows. The following table illustrates this last point :—

POPULATION AND REVENUE IN THE UNITED KINGDOM.

Year ended March 31.	Total Revenue.	Percentage Increase.	Population.	Percentage Increase.
1881	8,187		3,488	
1891	8,949	9·3	3,773	8·1
1901	13,038	45·7	4,146	9·9
1911	18,509	41·9	4,522	9·1

The units in column two is £10,000 and in column four 10,000.[1]

[1] See Bowley, *Elements of Statistics*, p. 159, for increase in yield of various taxes during period 1850 to 1905, shown graphically.

CHAPTER II

PUBLIC INCOME

1. CLASSIFICATION OF THE INCOME OF THE STATE.—Before considering in detail the various items in the public revenue, it will be advantageous for us to attempt to classify them. For our purpose it will be convenient for us to follow Adam Smith and to distinguish a double aspect of the State.

(1) As what the lawyers call a "legal person" who may hold property and engage in commerce.

(2) As the sovereign authority, having among its attributes the power to levy taxes.

Flowing from this twofold view, we get the two great classes into which all sources of revenue can be placed :—

(1) The *non-tax* or public economic revenue.

(2) (*a*) The *tax* revenue.

(*b*) Fines and penalties.

(*c*) Fees.

Fines are, of course, obtained from the courts of justice throughout the country. Prof. Seligman defines a fee as being "a payment to defray the cost of each recurring service undertaken by the government primarily in the public interest, but conferring a measurable special advantage on the fee-payer "[1]—for example, the patent fees or the cost of a marriage licence.

2. THE NON-TAX REVENUE.—We will consider the principles and methods of taxation in later chapters and take now the non-tax revenue. This is usually obtained from one of two sources:

(1) State property.

(2) State industrial concerns.

The soil on which it was situated was the first kind of public property owned by the primitive society and political science shows that it was not until man busied himself with comparatively sedentary occupations like agriculture that the rudimentary conception of private ownership began to arise—probably family ownership was the first form which was evolved. The king, however, generally held vast areas of land which as time went began to be looked upon as public land in that it provided him with a large part of his revenue; but it was with the gradual break-up of the feudal system that the royal demesne (in England) became smaller and smaller, until to-day the revenue obtained from the Crown lands amounts only to about £700,000.

Remembering the three characteristics of land—that it is an essential factor in the production of wealth, that it is limited in quantity and is everlasting—it is inevitable that landed property should increase in value with the growth of the population of a country, and some thinkers have once again

[1] *Essays in Taxation*, p. 432.

turned their eyes towards the time when the land belonged to the State; they profess to show that by acquiring the ownership of its land the State would increase its non-tax revenue. We cannot enter into the various schemes of land nationalization that have been proposed from time to time, but we may notice in passing that originally the justification for private ownership in land rested upon social utility. As Arthur Young puts it, "Give a man the secure possession of a bleak rock and he will turn it into a garden." This consideration, of course, applies principally when the owner is the actual cultivator or occupier of the land; it can hardly be said to obtain when he is an absentee landlord, who leases the land to the occupier or cultivator, in which case "it can make little difference whether he is the administrator of a private estate or an official of a well-organized government,"[1] and the same is the case particularly with town and urban land on which houses are built. Forests, too, are in rather a different category; it is surely no exaggeration to say that afforestation is a social concern—cut down the trees and you might alter the climate of the country.

When we come to the returns from any public industrial concerns we find that Adam Smith is quite definite here—"No two characters seem more inconsistent than those of trader and sovereign."[2] This is about the extreme limit of *laissez faire*; while, on the other hand, the tendency with a

[1] Seager, *Introduction to Economics*, p. 518.
[2] *Wealth of Nations*, Bk. V, ch. 2.

number of German writers is to consider that "trader" and "sovereign" are often most desirable "persons" to be under the same roof! Controversy has waxed fiercely over many suggested forms of State industrial enterprise—e.g., coal-mining—but we must remember that financial considerations are not the only ones which enter into the whole question of public ownership[1]—each suggestion for public industrial action must be considered on its own merits, we cannot definitely lay down that private or public trading is always in itself undesirable. There are, however, two important classes of industries in which public ownership has been established in a good many instances. These classes are:—

(1) Industries producing important monopoly products.
(2) Industries connected with the means of communication.

Examples of these industries are the electricity, gas and water supply on the one hand and the letter-carrying department of the Post Office, railways, canals and wireless telegraphy on the other. Notice that in the first class that although in most cases the fact that the costs of production tend to decrease as the industry grows (as, for instance, in the case of a water supply when a main pipe has been laid), the determining feature which generally decides for public ownership is the *quality* of the service supplied. Thus the field for

[1] Although, as a fact, they are often left out in many present-day schemes for *acquiring* public ownership.

public action may become wide, but a highly developed public interest is necessary, and a clear demonstration that the social benefits to be gained in any one case are worth the outlay of public money.

3. THE DEVELOPMENT OF A TAXING SYSTEM.—This short account of our non-tax sources of revenue has shown that from the point of view of their net yield to the Exchequer [1] they are nothing like so important as the taxation sources. It is possible that in the future the country may consider it a good thing to increase its non-tax revenue by entering further into the industrial domain. In the past, taxation certainly was considered an *exceptional* source of revenue, so it may be useful if we show briefly how our taxing system has developed.

The earliest form of public revenue was obtained from the property (land, cattle and slaves) of the chief, but it was in the Eastern Empires (Assyria and Babylon) that finance was first organized. Tribute from conquered peoples was then, as in later ages with the Romans, an important source. Greece had a fairly well developed financial system; the State-owned silver mines at Laurium produced a considerable amount of non-tax revenue, to which market dues and a tax on resident aliens also

[1] The origin of this word is interesting. "As a financial body [the King's Court in the eleventh century], its chief work lay in the assessment and collection of the revenue. In this capacity it took the name of the Court of Exchequer, from the chequered table, much like a chess-board, at which it sat and on which accounts were rendered." Green, *Short History of the English People*, p. 93.

contributed. Rome, in the early days of the republic, filled her exchequer by a property tax, and later by the taxation of the conquered provinces. She had, too, customs duties and a tax on the purchase of slaves. It is interesting to note that a class of capitalists (the Equites or knights) who sought to control the farming of the provincial taxes formed an important and powerful party in Rome.

Passing on to our own country, we find that at the time of the Norman Conquest the chief revenue sources were the royal demesne and the royal prerogative. The former yielded feudal dues, ground rents and various tolls and fines; later, towns began to purchase charters and so obtain immunity by paying a lump sum. The prerogative of taking subjects' goods was exercised, for example, when the king travelled through the country and required hospitality for his retinue. Taxation was only of an occasional character at first and usually for some specific object; thus *Danegeld* first levied in 991 by King Ethelred was to obtain money to bribe away the Danish invaders, and *Shipgeld* was originally imposed on coast towns to provide money for a navy—later, Charles I's attempt to impose it on inland towns led to the famous Hampton case in 1638.

Customs duties soon came into use.[1] Thus, 1275, Edward I was granted a duty on wool, sheep-

[1] The poet Chaucer was appointed Comptroller of the Customs of Wool at Port of London in 1374. "While nigh the thronged wharf Geoffrey Chaucer's pen moves over bills of lading."—William Morris, *Earthly Paradise*.

skins and leather passing out of the country, and in 1302 a "tunnage" of 2*s.* a tun of imported wine and a "poundage" of 3*d.* per pound on a number of other goods was levied.

Under the feudal system personal service was required of the King's tenants-in-chief, but by the time of the Plantagenets this developed into *scrutage* ("shield money"), a money payment in lieu of personal military service; further, a tax on land was levied called the *carucage*—a caruca was a plough team of eight oxen. Later these two taxes were replaced by *tallage*, a tax on property which in 1334 was fixed as a tenth on demesne tenants and a fifteenth in the case of others, and so got its name of "fifteenths and tenths."[1] This was replaced in Cromwell's time by monthly assessments of real and personal property, and after the Restoration a land tax at 4*s.* was levied. In 1798 Pitt converted this tax into a rent tax, and permitted landowners to redeem their future payments by the payment of a capital sum. Finally, by the Finance Act of 1896, an attempt was made to remove the anomalies which had accumulated; in no case was an assessment greater than 1*s.* in the £ to be made, or one less than 1*d.*; while two years later exemptions for owners with incomes less than £160 were made. The land tax is of little importance to-day, in spite of the changes introduced by the 1909 Budget, which we shall mention later.

To return again to the Middle Ages. In 1377 a

[1] The tallage paid by the Jews in England was an appreciable part of the revenue, as Edward I realized when he expelled them.

poll tax of 4*d*. per head was levied, and the same happened at intervals until 1698. It was the unjust collection of this form of tax which was the immediate cause of the Peasants' Revolt of 1381. The income tax is the modern descendant of the poll tax. The excise and stamp duties which were introduced from Holland in the seventeenth century we will refer to in Chapter IV. Particularly during the reigns of Elizabeth and James I, use was made of trading monopolies; not only was money raised by their sale, but they were also a convenient way of enriching court favourites—until parliament grumbled!

During the nineteenth century our taxing system was radically altered in accordance with the prevailing economic and financial ideas, for it was roughly during this period that the greatest contributions to the theory of public finance were made, but before we discuss in detail the various taxes we had better make a brief survey of the general principles and theory of taxation.

CHAPTER III

THE THEORY OF TAXATION

1. The Distribution of Taxation.—If we have been able to keep any particular theory of the State out of our consideration of public expenditure, it seems imperative that we have one in the background, as it were, when we deal with the public revenue. Important questions crop up immediately; if public revenue contains returns from non-tax sources and from taxation, is it possible to increase the former; is it to the advantage of the common weal that this should be done? Or again, when we take the revenue obtained by taxation, how ought the burden to be distributed? The answers to questions like these will be governed by the view we take of the function of the State. Let us consider one or two possible solutions.

An individualistic theory (such as taught by Herbert Spencer in *Man versus the State*) would lead, so to speak, to man having as little as possible to do with the State. He needs, say, protection and justice, and experience shows that these can best be obtained in a society; the taxes he pays may be a *quid pro quo*, a payment for the services rendered. That such a view leads to absurd conclusions is easy to show. Does it not cost just as much to protect a man not blessed with very much of this world's goods as it does to protect a rich person? If we consider only real property, it may be that the cost of protecting it does not increase proportionately with the amount and, at any rate, "if security is to be sold like an ordinary commodity, there ought, on the strictest commercial principles, to be some allowance made to the purchaser of a large quantity."[1] Equally absurd is the idea of everybody paying an equal share of the revenue required.

On the other hand, a State can be considered as the most definite institution in society; and, further, since from one point of view wealth has no meaning except in a society, the part played by that society in the production of wealth may be looked upon as making the State "the residual owner of all income which exceeds the requirements of maintenance and normal growth."[2] A further extension of the same idea would be for the State to attempt to level the existing large inequalities in the incomes of its individual members by a heavily graduated tax. Thus the socialistic ideal is widely different from the individualistic one. Is it possible to arrive at the golden mean?

As a preliminary to this it seems necessary to get rid of any sort of *a priori* reasons for an individualistic or a socialistic view of the functions of government; it may be argued that it is impossible

[1] Bastable, *Public Finance*, p. 299.
[2] J. A. Hobson, *Taxation in the New State*, p. 76.

to lay down any general principles which apply to every case of State interference; each example has to be judged on its own merits—statistics can help us here, but it is difficult to see the use of applying any hard and fast rule. If this be the case, we reach the *faculty* or *ability* theory of taxation. Provided that the sole aim in imposing taxation is to obtain revenue, then a reasonable distribution of taxation could surely be based upon the citizens' "abilities to pay." The difficulty comes in when we try to assign a definite meaning to this idea; at the present time it is the most generally accepted theory, but possibly that is because it is so conveniently vague. "Ability to pay" has at least three different and distinct meanings. We may consider it entirely from the point of view of *equity* or from that of the *consumption*, or of the *production* of wealth.

If taxation is to be levied solely to obtain revenue, then *equality* may be a very desirable ideal at which to aim. But what does equality mean? Obviously that everybody should not pay an equal share of taxation, and there are three important possible forms of distribution which have been suggested from time to time; each is intended to secure equity and each supposed to be based on the "ability to pay."

The first is the *pure proportional* form; taking income as the standard, it is laid down that the criterion of ability to pay would be attained by taxpayers paying *in proportion to their income*—proportion being considered in the strict mathematical sense of the word. This is perhaps the view of Adam Smith, but surely it must be repudiated by common sense, as a single example will show. Suppose that a quarter of a man's income was required by the State; then a man earning £10 a week would pay £2 5*s*., and the one getting £2 a week would pay 10*s*. each week; the first man might now no longer be able to keep a motor cycle, while the latter would hardly be able to feed his wife and family.

Such considerations as these have led men to think of a *progressive* or *graduated* form of distribution, in which the *rate* of taxation levied increases with the size of the income. But another aspect of the matter can well be brought in here. J. S. Mill says: "Equality of taxation, therefore, as a maxim of politics, means equality of sacrifice. It means apportioning the contribution of each person towards the expenses of government, so that he shall feel neither more nor less inconvenience from his share of the payment than every other person experiences from his." But he is considering only the consumption aspect of income. He is asking, in effect, "How much ought a man to pay in taxation and how much ought he to have left for his own consumption?" but surely we ought to consider also his *production* as well as his consumption of wealth. "In estimating a man's faculty or ability to pay we must not alone think of the burden imposed on him in parting with his property or income, but we must also consider the opportunities he has enjoyed in securing that property or income."[1] If this is so, we have a plain case that equity requires a graduated rate of taxation; many higher incomes (and the so-called "unearned" incomes) are obtained as the result of particular privileges—particularly that of inheritance—and this legal or social privilege enjoyed in the production of an individual's income increases its "ability to pay." The strongest argument against this graduated form of taxation seems to be that it checks saving. But so also, in a way, does any form of taxation; a progressive system affects most considerably the very large incomes, but it encourages saving among the middle classes and the people with relatively small incomes.

It should be noticed that although income and inheritance taxes are the particular ones to which graduation is most easily applicable, yet progression can also be realized to a certain extent by levying heavy taxes on luxuries and the better kinds of a number of articles.

Thirdly, we come to a form of distribution which may be called a *qualified proportional* one. Here, once again taking income as the standard, "equality of sacrifice" can be obtained (it is said) by exempting a certain amount of income and levying a uniform or possibly a slightly graduated rate of tax on any income above that limit. This is, of course, the way in which our present income tax works, which allows "a personal allowance" of £135, or £225 "in the case of an individual whose wife is living with him," to be free of income tax.

[1] Seligman, *Essays in Taxation*, p. 339.

2. THE PRINCIPLES OF TAXATION.—Having discussed briefly the distribution of taxation from the point of view of equity, it remains for us to consider the tax system with regard to its effects on the production and consumption of wealth; but before doing this it will be useful for us to get a clear idea of what a tax really is, of two important classes of taxes, and the general principles or "canons" of any tax system.

Our word *tax* is derived through the French from the Latin verb *taxare*, meaning *to value, to assess*, and Prof. Bastable defines a tax as being a "*compulsory contribution of wealth of a person or body of persons for the service of the public powers.*"[1] Note this definition carefully; every word in it is of importance. A tax is *compulsory*, we have to pay it whether we like it or not; it is a definite *contribution*, a giving up of the individual's wealth—that is to say, it is a sacrifice—for the use of the *public powers*, which include, of course, the State and the local authorities.

That there are different kinds of taxes is perfectly obvious—e.g., there are the customs duties and the land tax—but all of them can be placed in one of two large classes. To quote Mill once again—"Taxes are either *direct* or *indirect*. A direct tax is one which is demanded from the very persons who it is intended or desired should pay it. Indirect taxes are those which are demanded from one person in expectation and intention that he shall indemnify himself at the expense of another."

[1] *Op. cit.*, Bk. V, chap. iii, p. 1.

Obvious examples are the income and inheritance taxes on the one hand, and customs duties on the other. The distinction between direct and indirect taxes perhaps is not strictly scientific, and certainly there has been a good deal of controversy about the merits of each of the classes; on the one extreme is the "single taxer," and on the other the optimist who would have a tax system pressing on "an infinite number of points." But the true inference seems to be that a variety of taxes is necessary—some direct and others indirect—with the possible tendency, as the taxing system is developed, to increase the proportion of direct taxes.

Now, as has been pointed out above, our present system of taxation has been evolved empirically; men paid taxes centuries before any definite principles of taxation were laid down. As a fact, however, if we were to sit down and try to think what tests we ought to be able to apply to a good taxing system, I think we should soon arrive at four important ones. The taxes should be *just*, they should be as *simple* as possible, they should be *economical* and *productive*. The principle of justice, for instance, immediately cuts out a taxing system such as there was in France before the Revolution of 1789; or, to take another example, the principle of economy would seem to imply that taxes should be placed as far as possible on manufactured goods and not on the raw material used in the production of those goods[1]—thus Mr. Gladstone in 1880 did

[1] For two reasons: (1) because the raw materials may have to pass through the hands of a number of producers each of

away with a tax on malt, but imposed one on beer.

Adam Smith, our first economic writer to be both great and popular, in Book V of his *Wealth of Nations,* deals with public finance, and in the second chapter he gives his four "canons," or rules, to which every tax system ought to conform. Here they are :—

1. The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities ; that is, in proportion to the revenue which they respectively enjoy under the protection of the state.
2. The tax which each individual is bound to pay ought to be certain and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every person.
3. Every tax ought to be levied at the time, or in the manner, in which it is most convenient for the contributor to pay it.
4. Every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible over and above what it brings into the public treasury of the state.

whom would have to pay the tax and the interest on the outlay of the man from whom he bought the material ; thus the ultimate cost of the made-up article includes all these various advances of interest ; and (2) because the whole industrial system may be affected by a common and necessary raw material like coal or iron.

It will be noticed that these canons are only common-sense rules; there is nothing startling about them; they are, indeed, hardly original, for you can find them almost word for word in some of the French writers, to whom he owed a good deal of his economic theory. Canon 1 obviously must be applied to the tax system as a whole, while the other three apply to each and every tax of the system. They may be considered as financial maxims, and various writers have given lists, each containing any number of precepts from two to sixteen, e.g., including such rules as that a tax should be elastic and innocuous.

3. The Shifting and Incidence of Taxation.—Returning for a moment to Adam Smith's first canon, we see that he says that citizens should be taxed "in proportion to their respective abilities" (to pay), and we can now conveniently resume our discussion of the meaning of this ideal. A tax is a deduction from a person's wealth which consists economically of two parts, his *capital* and his *income*; of course probably a good deal of the former is derived from his income, but nevertheless we can distinguish the two parts. On which of them shall taxation be incident? The answer of Adam Smith and Ricardo is that it must fall on income, for if it were imposed on capital it would hinder its growth;[1] the force of this last point is obvious and we can accept the statement that, in

[1] We shall return to this point later on in connection with the suggested levy on capital. Mill adds, "To provide that taxation shall fall entirely on income and not at all on capital, is beyond the power of any system of fiscal arrangements."

general, taxation ought to fall on income. But with the present organization of society the sources of income are *wages*, *interest*, *profit* and *rent*, and so we reach the conclusion that a tax must ultimately be paid out of one of these.

Taking these four sources in turn, we will deal first with *wages*. From the point of view of mere physical efficiency as well as morally there is a minimum wage—call it a "subsistence wage" if you like—and in any given trade this rate of remuneration has further to be able to maintain a constant supply of new workers. Undoubtedly to-day it is difficult to fix the actual amount of a subsistence wage now that higher standards of comfort have been set up among many of our workers, but we must conclude that a standard wage is a necessary "*cost*" and has no ability to bear taxation.

Similarly there is a minimum rate of *interest* in payment for the use of capital in order to induce fresh supplies of that factor in production. It is quite probable that if no interest were obtainable money would still be saved, but the point which is important here is that capital, in order to be of use in the production of wealth, must usually be *lent*, and in order to induce people to lend money or capital goods some rate of remuneration is necessary.[1]

Much the same holds, too, in the case of profit, which in technical language means the remuneration of business men or *entrepreneurs* for the work of

[1] *Cf.* Tawney, *The Sickness of an Acquisitive Society*, ch. 7.

organizing and conducting a business, and we must recognize that part of it at any rate—it is a necessary cost which is unable to bear a tax.

When we come to the last source of income, rent, we may well pause and ask if there is any necessary cost here. The classical economists would answer with an emphatic no ; Mill is even more than usually eloquent on this point ; he says, "The ordinary progress of a society which increases in wealth, is at all times tending to augment the income of landlords ; to give them both a greater amount and a greater proportion of the wealth of the community, independently of any trouble or outlay incurred by themselves. They grow richer, as it were, in their sleep, without working, risking or economizing. What claim have they on the general principle of social justice to this accession of riches ?"[1] According to Ricardo's famous theory, rent is a natural surplus arising from the fact that some pieces of land are more productive than others and consists of the value of the produce of land in excess of value of the produce of land which it is just worth while cultivating and so just pays the necessary cost of cultivation. Like many other "economic laws," this is really only a truism ; rent is a payment for differential advantages, such as those of a more fertile soil or a better situation, and in general a rent payment arises because the supply of land for any given purpose is limited and so a scarcity price has to be paid for it. When considering an individual we can also speak of a "rent of ability" ;

[1] Mill, *op. cit.*, Bk. V, ch. ii, p. 5.

although when large fortunes are made in a profession very often these are only part of the price paid for the requisite training to enter that profession. A given piece of land can generally be used for a number of different purposes and, in order to induce the owner to let his land for the most productive use, some remuneration may be considered necessary. Further, a landowner has sometimes applied capital to his land and a portion of the rent he expects to get is, strictly speaking, only interest on the capital he has laid out.[1] However, the fact remains that a large part of what is termed the rent of a piece of land could be taken in taxation without causing a reduction in the supply of this agent of production—it is a surplus and, as such, has ability to pay.

Bearing in mind these distinctions between *costs* and *surplus*, let us now see how taxes are paid. One method of raising public revenue is by use of an income tax, which is of course a direct tax. Mr. S. B. Rowntree, following his investigations into the social condition of the working classes, concludes that 35*s*. 3*d*. a week (or £91 13*s*. a year—this is considering July, 1914, prices) is the subsistence wage for a man with a wife and three young children to support. If now we can conceive that all incomes above £80 are to be taxed directly, by means of an income tax, our workmen would have to pay a tax on £11 13*s*. By hypothesis there is no

[1] This refers only to perishable improvements to the land; permanent ones from which the capital invested cannot be withdrawn must be considered as part of mother earth and obey the law of rent and not of interest.

surplus in his wage and he could not pay the tax and continue to live. Labour would tend to flow out of the industry paying this subsistence wage and competition between employers would then tend to raise the wages paid. In other words, the tax has been shifted—we will return to this point in a few moments. As a fact, supposing that all incomes above £100 were taxed, then probably the labourer would not trouble to increase his wages more than about £8 by working overtime, as he would then begin to pay income tax. This difficulty of obtaining a share of taxation from some of the unskilled labouring classes has led to the adoption of many of our indirect taxes, the assumption being that the person who buys a taxed commodity pays a tax in the increased price of the article. "The consumer pays" is the popular phrase expressing this idea, but let us consider a few typical cases and try to find out if the consumer does really pay in every case.

We will take first of all a tax on, say, a unique kind of sparkling natural spring water. The producer of this drink has a monopoly of its supply and will already have so fixed its price that he obtains the maximum returns. When the tax is imposed, he cannot raise his price, if he does not wish his sale to be reduced; in fact, his surplus profit has to bear the tax.

Suppose, however, a tax were imposed on the sale of motor cycles.[1] A good many people can only

[1] It is interesting to notice that motor cycle dealers now frequently give in their advertisements the amount of the tax to be paid on their machines.

just afford the upkeep of this luxury, and if the price was increased they would no longer buy. In technical language, the demand for motor cycles is elastic; thus if the dealer placed the tax we suppose he has to pay on the price, the sale of machines would be decreased and in consequence the rise of prices checked; they *would* rise, but not to the extent of the whole of the tax, and some of it would be shifted on to the producers, who, if they were enjoying only normal profits, could not allow it to lie there, but would inevitably shift it further back, perhaps to the tyre manufacturers.

Again, let us imagine a Budget imposed a tax on bread, say of 2*d.* a loaf. Bread is practically a necessity of life, and supposing all similar foodstuffs taxed in the same proportion, what will happen in this case? If the price of a loaf is raised by the amount of the tax (2*d.*), the housewife will necessarily spend more on her bread and must buy less of other and less necessary articles, thus affecting the production of these articles. But probably she will first of all revise her consumption of bread, and, attempting to economize, purchase less of it. This reduction in demand (although it may only be slight) will bring down the increase in price and the actual rise will be something less than 2*d.* per loaf (say $1\frac{3}{4}$*d.*), the other farthing being shifted on to the miller, the farmer or some one who has had to do with the production of the loaf and has a surplus to bear it.

During the late war an Entertainments Tax was imposed and the prices of the various seats in, say, a cinema, were increased. By how much? By the amount of the tax. The prestige of the cinema has become so great in modern life that in this case undoubtedly the consumer does pay the whole of the tax, but the young stenographer who craves for the "pictures" will, once again, have to lessen her purchases of other commodities.

These four cases illustrate the problem of the shifting and incidence of a tax. It is a difficult problem; every tax must be treated separately and the only guide we have to follow is that a tax will tend ultimately to fall on a surplus. If it does not do so immediately, shifting will take place until a surplus is found. But is this shifting eminently desirable? It seems doubtful. If a tax is imposed on a subsistence wage, it must be shifted first of all on to the employer by a rise in wages; if he cannot bear the increase, i.e., if his profits are only normal, it must be shifted again, perhaps on to the cost of the commodity produced. Who buys this? Most probably, in the case of a great many articles, some of the workers are also consumers and they cannot bear the tax even in its new form, and the shifting process would begin again.

We have, however, been supposing almost impossible conditions. Men are often lazy and indifferent; frequently they do not show a great deal of intelligent self-interest, and so there is inertia introduced into the shifting machinery, there is friction, waste and injury to production. These points must be considered when we examine the merits of a multiplicity of indirect taxes as a means of obtaining revenue.

Let us recapitulate the above argument :—

(1) In general, taxes will be paid out of income.

(2) All sources of income may consist of two parts :

(*a*) Necessary costs.
(*b*) Surplus.

(3) Taxes will tend to be paid out of the surplus.

(4) If a tax is levied on cost, shifting will take place to move it on to the surplus. In connection with the shifting process we can distinguish the following cases :

(*a*) In the case of a monopoly, the tendency is for the producer to pay.
(*b*) With an ordinary luxury, the demand here being fairly elastic, the tendency will be for a new tax to be shared by the consumer, the middleman and the producers.
(*c*) In the case of a necessity, the tendency will be for the consumer to pay nearly, if not entirely, the whole of a new tax.

4. USE OF DIRECT AND INDIRECT TAXES.—It is curious to note how public opinion has changed ; in the thirteenth century indirect taxes were advocated to secure *equality* of taxation, for the simple reason that the clergy, the nobles and the upper classes were largely exempt from direct taxes. Afterwards, when some of these gross inequalities were removed, we can notice a tendency to favour direct taxation because of its supposed "immediate" incidence—as, indeed, might be suggested by the line of reasoning used in this chapter. Then, at about the

beginning of the nineteenth century, came the *diffusion theory of taxation*,[1] which asserted that ultimately all taxes, however imposed, are diffused equitably over the whole of society; competition was supposed to do this, and the view still seems to lurk behind the common expression that "an old tax is no tax." To-day public opinion is once again beginning to assert the desirability of direct taxes.

With indirect taxes shifting usually occurs and in this process more than the actual amount of the tax originally levied may sometimes be transferred from producer to consumer; the canon of equity, too, is often violated, as when the articles taxed are those of general consumption which are used, in proportion to the consumption of other goods, much more by the poor than by the rich. Indirect taxes are occasionally recommended because paying them is purely "voluntary." Mill [2] exposes the fallacy of such a view; if a £5 tax is imposed on the wine a man drinks in the course of a year, he need not pay this tax by giving up drinking wine. "But if the £5, instead of being laid on wine, had been taken from him by an income tax, he could, by spending £5 less in wine, equally save the amount of the tax, so that the difference between the two cases is illusory."

On the other hand, the levying of a direct tax (e.g., on income) needs an assessment, and unless official action is to become inquisitorial the co-

[1] This theory was first advocated by a French economist named Canard in a book published in 1801, attacking the current doctrine that all taxes were ultimately incident on landowners.

[2] *Op. cit.*, Bk. V, ch. vi, p. 1.

operation of the person who will pay the tax is needed; thus opportunities are afforded for evasion if a sufficient sense of public duty is lacking. Further, we have shown above that it is practically impossible to impose a direct tax on people possessing only the slightest margin of surplus income, and the only practicable way of obtaining contributions from them is by a tax on commodities; exempting the necessities of life (like bread) would spare those getting nothing but an absolute subsistence wage—and so with no surplus to tax—only on the supposition that they spent that wage on buying necessities.

Such advantages and weak points as these suggest that only by combining direct and indirect taxation can we obtain an equitable taxing system.[1] No single tax by itself can be quite fair in its incidence; while, from the point of view of receipts into the Exchequer, it is only by using both elastic and inelastic taxes that a reliable amount of revenue can be obtained.

5. INTERNATIONAL DOUBLE TAXATION.—There is one other problem of some theoretical and practical interest which we may just notice briefly here. If an Englishman carries on a business in England, has property in Germany, and lives in France, by which country should he be taxed? Questions like this have become acute owing to the development of international relations and commerce, but they have been particularly discussed in the United States,

[1] Although no hard and fast rule can be laid down such as half of a total revenue from each kind.

where cases of double taxation—i.e., the same person or thing taxed twice over—are more common owing to the variety of taxing systems in use among the different federal states. The oldest answer to the problem would be that the man should be taxed by the country to which he owes "political allegiance," but such a solution is obviously inapplicable to modern conditions; in the days of independent city states such an idea was useful—to-day the population of a country may consist of many other people than natives, and Prof. Seligman proposes what he calls the principle of *economic allegiance*, by which "every man may be taxed by competing authorities according to his interests under each authority."[1] In practice this amounts to the country or state in which a man has property, taxing that property (*qua* property), while the country where he lives taxes the consumption of his income, directly or indirectly. This is perfectly reasonable, but there are practical difficulties in applying it—for instance, in the case of foreign stock, and particularly with the inheritance taxes. A means of obtaining the ideal and so abolishing a good deal of unjust double taxation seems to be by international agreement[2] and reciprocity.

[1] *Essays in Taxation*, p. 113.

[2] Thus in the case of the British Empire this might be arranged by the Imperial Conference.

Appendix to Chapter III

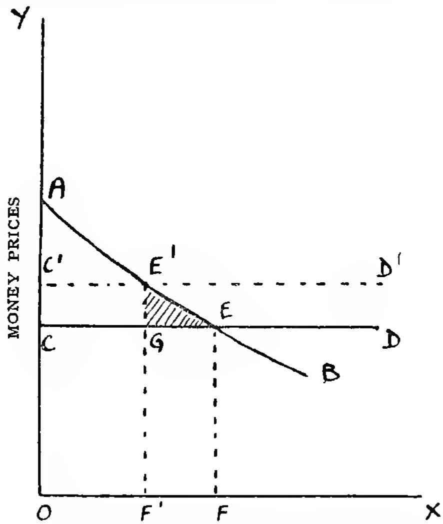
DIAGRAMMATIC ILLUSTRATIONS

In that branch of economic theory which deals with the exchange of commodities diagrams can be used to illustrate a number of difficult points; thus by means of a simple geometrical figure it is often easy to make deductions which otherwise would need a good deal of explanatory reasoning. Perhaps diagrams cannot be used to any great extent in connection with the theory of taxation, but the following simple illustrations may be suggestive of a possible method and will supplement the line of reasoning used in the last chapter.

It is an elementary fact that in the case of a great many commodities the amounts which will be bought will vary with the price at which they are offered for sale. Thus an average householder might buy one ton of coal a year if it were £10 a ton, two tons if it were £8, and seven if it were £1 10*s*. If we take two lines, OX, OY, at right angles to each other, set out the money prices of a commodity along OY and the corresponding amounts bought along OX, what is called a *demand curve* can then be plotted, from which we can see that for any price represented by OC an amount represented by OF will be purchased. We have used the word "elastic" with reference to demand, and in ordinary language what is meant by this term will be perfectly plain; economists, however, have introduced methods of measuring elasticity, but it will be sufficient for our purpose to notice that, providing the scales on which they are drawn are the same, the *steeper* a demand curve is at any given point the *less elastic* is the demand at that point.

Similarly what is called the *supply curve* can be drawn, for which the total money costs of production are measured along OY and the corresponding amounts produced along OX. In general there are three distinct forms for the curve; if it is a horizontal line parallel to OX this means that, whatever the output, the costs of production are the same, or in technical terms, the law of constant returns holds; if it slopes upwards to the right, it means that the costs of production increase with the output or that the law of decreasing returns is in force; while if it slopes downwards to the right, then the costs of production decrease with the output and we have then the most usual case in manufacturing industries, that of increasing returns. Although we cannot go any further into the matter here, it ought to be fairly clear that where supply and demand curves for the same commodity intersect will, in general, be the *normal price* at which the commodity in question will be bought and sold.

In Figs. 1 and 2 are drawn the demand (AB) and supply (CD) curves for two different commodities, supposing, for simplicity, that in each case the supply is at constant returns, but that in Fig. 1 the demand for the commodity in question is more elastic than for Fig. 2. E is the point where the two curves meet, so that OC is the normal price and OF the output at that price. If now a tax amounting to CC′ is imposed on each unit produced, we can suppose that this in the first place means an increase in the cost of production, which, geometrically speaking, means that the supply curve must be raised an amount equal to CC′, so that C′D′ is its new position. OC′ is the new normal price and the demand is decreased by FF′. Now the area AEC before the price was raised is known in modern economics as the *consumers' surplus*, for the amount OF produced and the price OC charged, and it is a measure of the excess of the price which a purchaser might perhaps pay for the goods rather than go without them over what he actually does pay—thus if I am willing



OUTPUT, OR AMOUNT DEMANDED

FIG. 1.

to pay as much as 6*s*. for one pound of beef and can and do buy one pound for 1*s*. 6*d*., my consumers' surplus is 4*s*. 6*d*. Obviously this is reduced to AC′E′ when the price is increased, so there is a decrease represented by area CEE′C′. But the amount of revenue obtained will be represented by area C′E′GC and so the loss of consumers' surplus exceeds the gain to the government by the area EGE′, and this is greater in Fig. 1 than in Fig. 2—or, in other words, if other things are equal, most revenue will be obtained by taxing a commodity the demand for which is comparatively inelastic. Again if, as in Fig. 3, we suppose, as is usually the case, that the expenses of production decrease with the amount of the commodity manufactured, it is obvious that the

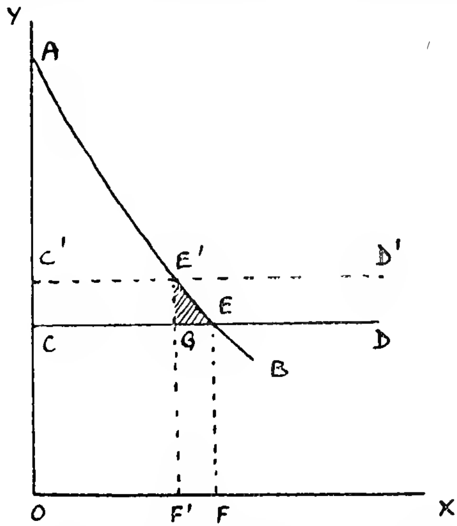
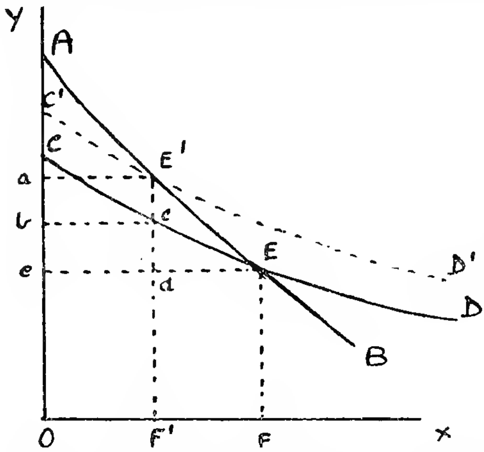


FIG. 2.

gain in the revenue, represented in this case by aE′cb, is less than the loss of consumers' surplus aE′Ee and that this loss becomes greater the more CD slopes downwards to the right—thus taxing a commodity which is produced under conditions of increasing returns has the effect of destroying parts of the advantages of this method of production.

Finally we may just notice the diagrammatic explanation of monopoly price. In Fig. 4 AB is the demand curve and CD the supply curve for a monopoly product supposing that we are dealing with production at constant returns, EF (equals CO) would be the price at which the commodity would be sold if competitive rates were in force, but the monopolist will endeavour to fix his price and corresponding output so that the largest possible rectangle (in this case, considering constant returns) can be drawn in the area AEC.



Tax is a b per unit, so supply curve C D is raised to C′ D′.

FIG. 3.

Thus if CE′GH is this maximum area, OF′ will be the output and OH the monopoly price. If, as the result of the imposition of a lump sum tax, he tries to raise his price, e.g., to OH′, then the rectangle CH′G′E″ will be smaller than HGE′C. If, however, a tax of so much per unit produced were imposed, then it is possible that he might restrict his output and so shift part of the tax on to the consumer. It should be noticed further that it would probably be more strictly correct to consider not one demand curve for the monopoly product but two or three, corresponding to the demands of two or three classes of consumers. Thus a brand of soap may be prepared which is meant to appeal to working-class housewives; if a dash of eau de cologne is added to it and a superior kind of wrapper used, the resulting product will then be made to fetch a higher price. In anticipation of the reasoning about import duties in Section 6 of the next chapter, it may be pointed out here that a "dumped" monopoly product will probably be sold in the importing country at a price determined by some point d to the right of G on the demand curve; while if the object of dumping is to attempt to capture foreign markets this price may be less than the costs of production, e.g., determined by d',[1] so that there is a "loss" on the "dumped" portion of the produce. Needless to say, the possibility of getting a net gain necessitates production under conditions of increasing returns, and when this obtains it is scarcely correct to consider separate costs of production for different units produced.

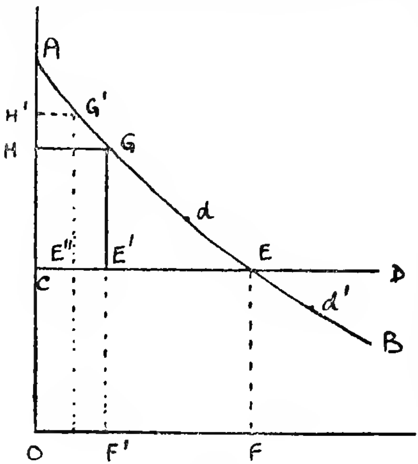


FIG. 4.

[1] The reader interested in these diagrams is referred to Prof. Marshall's *Principles of Economics*, Cunynghame's *Geometry of Political Economy*, and, for a simple introduction, to Chapman's *Outlines of Political Economy*.

CHAPTER IV

SOME IMPORTANT TAXES

1. The Income Tax.—Bearing in mind the chief points in the general theory of taxation which we have briefly discussed in the last chapter, let us now touch upon some of our most important taxes. Both from the point of view of productiveness and theoretic interest the Income Tax is our most important tax and with it we will begin.

If our analysis of income into *costs* and *surplus* and the reasoning that only the latter has " ability to pay " is correct, it would, at first sight, appear that the simplest way of levying taxation would be to place it only on surpluses. The practical difficulty, however, in doing this is enormous; in most cases we cannot *definitely* say that such and such an amount is a necessary cost and the rest is surplus. If you think for a moment of any source of income —wages, interest, profit or rent—you will realize the difficulty of the problem; this does not, however, invalidate our theoretical solution of it, which surely is logically irrefutable. At the best, we have to put up with what is expedient and the finest working rule we can devise will probably be far from perfect. If we propose to levy a direct tax on income, instead of attempting to distinguish costs and surplus in each case, the working rule seems to be that, in general, the larger the individual's income,[1] the larger will be the surplus. This obviously is very roughly the principle upon which the English Income Tax works.

As has been pointed out previously, the Income Tax is the modern descendant of the poll tax and the following points in its history will be of interest. First levied in 1799 by the younger Pitt, it was repealed in 1802, at the Peace of Amiens, reimposed in 1803 when the war began and was finally repealed in 1816 at the end of the fighting. Thus it began as a war-time tax and has, indeed, always been regarded in England as being particularly suitable for obtaining the increased revenue to meet war expenditure. As a peace tax, it was first imposed by Peel in 1842 for three years only, but the tax was found so fruitful that it has never yet been abolished. In 1806 the rate was 2*s.* in the £, 7*d.* in 1842, 1*s.* 4*d.* in 1856 (for the Crimean War), 2*d.* in 1874, 1*s.* in 1901, 1*s.* 3*d.* in 1903 (for the Boer War), and 6*s.* to-day.

The exemptions, too, obtaining at different times are interesting. In 1799 the limit of exemp-

[1] Obviously if an income of £500 has got to support a family of five people there may be little surplus in it; while if only one person has got to live on that amount there will be something left over when all necessary costs are paid. This fact illustrates one of the suggested reforms in our present Income Tax, i.e., to divide the income by the number of persons who have to be supported by it and then to apply abatements and exemptions (if necessary) to each individual income. See *How to Pay for the War*, by the Fabian Research Department.

tion was £60, in 1842 it was £150; in 1863 an abatement of £60 was allowed on all incomes under £200; in 1894, up to £160 was exempt from all incomes up to £400 and £100 for incomes from £400 to £500. In 1803 the present day system of classification of the sources of income into five schedules or classes was first introduced. These schedules are:—

Schedule	"A."	Owners of lands and houses.
,,	"B."	Farmers[1] and occupiers of land.
,,	"C."	Fundholders or receivers of interest from Government securities.
,,	"D."	Receivers of income derived from business, professions, etc., not mentioned in "E."
,,	"E."	Public servants.

Thus a large number of changes both in rates and exemptions have taken place since the Income Tax was first imposed. The most recent one was given in the Finance Act of 1920. This, in the words of the *Memorandum on the Provisions of the Finance Act*, 1920, "brings into operation for the year of assessment 1920–1921 a radical alteration of the method of granting relief in the Income Tax in favour of earned income as compared with investment income, and of the method of graduating the burden of the tax according to the size of the

[1] As a matter of fact, farmers can be assessed under either Schedule B or Schedule D. For agricultural land the assessment in the former case is at twice the rental value of the farm.

taxpayer's income and his family responsibilities." Briefly, to take the case of a single person with a totally "earned" income, this means to obtain his taxable income (i.e., that part of his income upon which the Income Tax is actually charged), one-tenth is first deducted and then a personal allowance of £135 and then on the first £225 remaining (supposing no other exemptions obtainable) an Income Tax of 3*s*. in the £ is levied. The remainder of the taxable income (up to £2,000) is charged at 6*s*. in the £; above £2,000 a graduated super tax is imposed.

A point which has been urged by Mill and a number of later writers is that the effect of the present system of levying Income Tax is to put a premium on spending. Not only is the income that is earned taxed (and so reduced in amount), but any of it saved and invested has its returns taxed once again, thus making the *effective rate* of taxation greater than it would be if the whole income had been spent, or, at any rate, not invested and so, presumably, not engaged in production. Mill adds that "the difference thus created to the disadvantage of prudence and economy, is not only impolitic but unjust,"[1] and he would have all savings exempt from taxation; another method suggested by Prof. Pigou is that savings should be exempted in the year in which they are made—but here, as is often the case in modern economic writings, surely the tendency is to "impute to the average taxpayer too rational and actuarial a psychology. Not every one—to put it mildly—who is in doubt how

[1] *Op. cit.*, Bk. V, ch. ii, p. 4.

much to save, will envisage the discrimination of an income tax against savings. Not every one, therefore, will be influenced in his decision by this discrimination."[1]

On the other hand, the present system of exemption from income tax of life insurance policies can also be criticized. The proposal just mentioned to exempt savings from taxation in the year in which they are made really amounts to a tax, not on income, but on *expenditure*. Mill mentions a scheme for a tax of this kind, but is hostile to it.

A great point in favour of the English Income Tax system is the possibility of collecting the tax at the source of income. This is particularly applicable in the case of some incomes coming under Schedules C, D, and E; collection at the source clearly makes for economy, but also we must realize that it tends to make a properly progressive income tax, under which every different income would pay at a different rate, more difficult to levy.[2]

2. THE INHERITANCE TAXES.—Closely allied and complementary to the Income Tax are the death, succession or inheritance duties. Historically they are quite ancient; Rome had an inheritance tax and we first come across them in English finance when a probate duty was levied as a part of the first Stamp Act of 1694. Later, legacy, succession and estate duties were added, but in

[1] Dr. H. Dalton, *Economica*, No. 2, p. 203.

[2] The concession of allowing an average to be taken over three years in the case of some incomes assessable under Schedules A and D probably works out equally in the long run—as theoretically it should—but is apt to be oppressive during lean years.

1894 Sir William Harcourt succeeded in getting rid of the anomalies which had crept in through the levying of these different taxes. A new Estate Duty was set up and the old legacy and succession duties continued for estates worth more than £1,000. It is also interesting to notice that the new Estate Duty was progressive. Estates under £100 were untaxed; from £100–£500 the tax was 1 per cent.; from £500–£1,000 it was 2 per cent., and so on. As Prof. Seligman says, "the definite acceptance of the progressive principle in English politics marks a most important step in the history of public finance."[1] This was in 1894.

How does our analysis of income into *costs* and *surplus* apply in the case of an estate duty? The answer is comparatively simple. The Income Tax does not touch, say, the increase in capital value due to the rise in price of securities; or again, it must be admitted that there are other ways of distributing large surpluses than by merely increasing the rate of interest paid (which an income tax could touch)—bonus shares, for instance, can be given. In addition to the Income Tax tapping the interest on these, an estate duty takes the share of the (capital) surplus which has been created. On the other hand, in the case of a succession duty which is to be paid by the person who succeeds to the inheritance, the income he thus receives is from a *privileged*

[1] *Essays in Taxation*, p. 456. An alteration in the Income Tax took place at this time. Previously the income under Schedule "A" (from lands and houses) had been assessed at its gross value. The cost of repairs, etc., was now taken into account and the rate increased from 7*d*. to 8*d*. in the £.

source and by the fact that it *is* a privilege, it has an "ability to pay." This does not, of course, obtain so much in the case of wealth left to a widow or children and is recognized and allowed for by different rates according to the relationship of those who receive the inheritance.

There is yet another aspect of the matter to consider. It is obvious that an excessive *rate* of taxation will tend to check saving; in that case, not only will the real income obtained be smaller and so less left after necessary costs have been paid, but also the double taxation of the interest earned by investing what is saved will be very trying (e.g., if the high general rate of 10*s*. in the £ be imposed, this means a tax of 15*s*. in the £ on saved income. See Prof. Pigou's *Economics of Welfare*, p. 629). At any period of economic history saving is important,[1] and this applies particularly to the extraordinary (financially) times through which we are now passing; if our system of taxation, and particularly the direct Income Tax, is so arranged that it is not too high to discourage saving from a middle-class income, surely it is only just and reasonable that the State should take at death a share of the capital which it has allowed to grow by foregoing its full share of the surplus as it is created?

Adam Smith is pessimistic about the incidence of an inheritance tax. He says: "All taxes upon the transference of property of every kind, so far as they diminish the capital value of that property,

[1] See J. M. Keynes' *Economic Consequences of the Peace*, ch. 2.

tend to diminish the funds destined for the maintenance of labour." But if our analysis of costs and surplus be correct, surely the "funds" referred to have been created because the surplus which has helped to make them (note that *costs* include the necessary costs of maintenance *and growth*) has not already been entirely wiped out by taxation; and in any case, when these "funds" are transferred by death to a new owner, then *to him* they are of the nature of a "windfall" and, as such, have an ability to pay.

3. THE INHABITED HOUSE DUTY.—Owing to its historic and theoretic interest, a tax on land might well detain us for a short space here, but, as its chief interest to-day seems to be in connection with local finance, we will postpone any discussion of it until we touch upon that subject.

Allied to the Land Tax is the Inhabited House Duty, which, as you might guess, is evolved from the ancient hearth and window [1] taxes—the possession of the "luxuries" of warmth and light being considered in those days as an indication that the householder could afford to be taxed. Since 1851 the present tax has been levied on buildings paying rents of £20 or more, and is graduated for rents between £20 and £60; thus 3*d*. from £20 to £30, 6*d*. from £40 to £60, and 9*d*. above £60; business premises, etc., pay two-thirds of these rates. There certainly seem to be a number of objections to the Inhabited House Duty. It is levied on the investment of capital in one of its most desirable forms

[1] A window tax is still levied in France.

(although, here again, perhaps the householder will hardly consider this point); it takes no account of whether the rents in the neighbourhood are relatively high or low—that town-dwellers pay more in proportion than do those who live in the country, while it is obvious that certain people (e.g., doctors) have to keep up a relatively good establishment. There is, too, no connection between the number of people who live in the house and the duty payable; thus a family of five[1] living in a house costing £40 a year has to pay the same as a single person occupying a £40 house; no account either is taken of the fact that rich people can sometimes afford two or more houses. Thus the present form of Inhabited House Duty appears to be far from just in its incidence; on the other hand, if it were reformed to remove some of the objections suggested above, and a proper graduation introduced, this form of tax seems to be very useful for raising revenue. The "fact" sometimes urged that it is impossible to secure a just distribution of taxation by any one tax is no reason why the distribution of every tax should not be made as just and as reasonable as possible.

4. STAMP DUTIES.—There is one other form of direct tax—or rather, a tax on acts—that we will consider briefly. This is the various Stamp Duties charged on a number of commercial documents

[1] Mill, with his usual Malthusian tendencies, says here, "Of this, however, he is not entitled to complain; since having a large family is at a person's own choice and, so far as it concerns the public interest, is a thing rather to be discouraged than promoted." *Principles*, Bk. V, ch. iii, p. 6.

and certificates. As a fact, however, it must be realized that the stamps duties are not a distinct form of tax; they are only a *way* of collecting revenue by the use (in a good many cases since 1881) of ordinary postage stamps. As was the case with the excise, stamp duties were copied from the Dutch and were first levied by an Act of 1694. Taxable documents were then classified under six heads, but various additions have been made since that date—thus bills of exchange have been stamped since 1782, and Mr. Gladstone introduced a penny (now twopenny) receipt stamp duty in 1853—and from 1870 four groups have been recognized. The first includes stamps on bills of exchange; the second, the stamps on cheques; the third, stamps on transactions relating to property; the fourth, stamps on deeds. An additional class includes the stamp fees payable on entering the legal profession. With the exceptions of the revenue obtained under the third head, it appears to be a slender and far-fetched argument that these stamp duties are a restraint on trade. Often they are so small (comparatively) that they can almost be regarded only as the expenses of State registration. However, in the case of duties payable on the transfer of property, this does not seem to be the case. "The duties directly payable on the sale are nearly 7 per cent., and with the stamps and fees the total charge is over 10 per cent. —i.e., where land sells for thirty years' purchase it amounts to at least three years' income. Such a rate is open to the severest condemnation as tending to immobilize the most important form of property and thereby reduce the productive power of the community."[1]

5. EXCISE DUTIES.—Having considered briefly some of our most important direct taxes, we must now turn to the indirect ones. A glance at the statement of receipts on p. 74 will show at once that by far the most productive are the customs and excise duties. These duties are taxes on the consumption of commodities, the former being levied at the frontier when the taxable article is imported (or exported), while the excise is imposed on articles produced in the country. Notice that customs and excise are only names for the *methods of collection* of a tax, and if an excise duty is levied a customs toll on the same article must also be imposed. Thus lager beer imported from Germany pays customs duty; beer brewed at Burton-on-Trent pays excise. There is, too, a connecting link between customs and excise in the use of *Bonded Warehouses* established at large seaports and in a number of inland towns. In these, goods liable to customs duties may be deposited; no duty is charged if the articles are again exported. Or if they come into the country, pay duty, and then are exported, possibly in an altered form, a *drawback* on the duty originally paid is allowed.

We may notice here, in passing, a general tendency in most countries with regard to indirect taxes. From about the middle of the sixteenth century Holland had been the chief trading country in

[1] Bastable, *op. cit.*, p. 587.

Europe, and in the first Navigation Act, passed in 1651 by the Rump Parliament, and the resulting Dutch Wars [1] which followed, we have a sure sign of the jealousy which existed between the two countries. The Dutch had, however, built up their national greatness by commerce; in Holland there was little or no landed aristocracy. But the trading classes had great objections to an "obvious" system of direct taxation, and we find the various stamp and excise duties invented to raise revenue; indirect taxes were preferred because their incidence was hardly so straightforward, and perhaps (it was thought) the community as a whole, and not merely the commercial class, might be made to bear them. Although a complete investigation of the industrial and financial situation in England for about the century before the industrial revolution has yet to be made, it is possible that, with the increasing prestige of the trading class, such ideas as these about the shifting and ultimate incidence of indirect taxes may have been in vogue. At any rate, they were evidently much obliged to Holland for showing them how to raise revenue in other ways than by directly taxing trading capital.[2]

Thus our present system of excise duties was introduced into England in 1643, at the suggestion of Pym ("the father of the excise"), with the original idea of raising revenue for the Parliamentarians to carry on the Civil War. In 1643

[1] New Amsterdam—afterwards called *New York*, after the Duke of York who became King James II—was ceded to England by the Peace of Breda, 1667.

[2] See Seligman, *op. cit.*, ch. 1.

duties were levied on a large number of foodstuffs; in 1660 beer was the principal article to be taxed, but the expenses of the European wars in which England was engaged soon caused many more commodities to come into the fiscal net. Generally speaking, the nineteenth century undid the work of the eighteenth as far as excise duties are concerned; thus the taxes on salt (1825), leather (1830), candles (1831), soap (1853), and paper (1861), and on many other articles were abolished, until at the present time, intoxicating drinks are the chief objects of taxation. This last-mentioned fact is important. In the financial year 1917–18, the beer and spirits duties yielded approximately £26,000,000 out of the total £38,000,000 of excise duties; or, in other words, about seven-tenths of the excise came from intoxicating drinks.

It is rare that temperance reformers look at the financial aspect of their problem; taking into account the customs duties levied on beer and spirits, we find that roughly (in 1917–18) one-twentieth of the total tax revenue of the country was derived from the sale of alcoholic drink. When vague ideas of prohibition are in the air, it is well to think of this side of the question. The fact remains, however, that an appreciable amount of revenue is obtained from the sale of what, after all is said, is to some extent a noxious "luxury." It should be noticed, too, that the tendency for the brewing and distilling trade to be concentrated in the hands of a few limited liability companies simplifies the collection of these taxes. This is the

English system; in France, the State retains the monopoly of tobacco manufacture,[1] and in England the question of public ownership of the liquor trade[2] has from time to time been mooted.

The incidence of an excise duty is, at first sight, a simple problem. The duty on, say, beer is levied on the brewer, who shifts it on and on until the consumer pays it in the increased cost of his drink. But two important points occur here; if the brewer is enjoying a monopoly of some brand of commodity he uses (e.g., a particular kind of water), then, quite in accordance with the theory laid down in chapter three, his surplus will probably bear some, if not all, of the tax. Again, the consumer *may* be able to shift his share of the tax. It is conceivable that a "luxury" which is excisable may be an article of very common consumption (a conventional necessity), and in this case the increased cost of living may cause a rise in wages, with a resultant disturbance throughout the whole industrial system. Once again, general principles are difficult to lay down, and the examination of a particular instance is necessary to see exactly the final result.

6. THE CUSTOMS DUTIES.—When we come to consider the customs duties, our subject is at once beset with many difficulties. Probably no other branch of public finance is more governed by so-

[1] "The insular position of Great Britain has been a further assistance in protecting her excise system from the introduction of contraband goods. Thus the price of the State manufactured tobacco in France has been varied according to the proximity of the district to the frontier." Bastable, *op. cit.*, p. 526.

[2] For a recent consideration of the problem, see A. Greenwood's *Public Ownership of the Liquor Trade.*

called political factors; this, however, must not blind us to the economic and financial aspects of the matter.

Historically, customs duties are much more ancient than the excise; market tolls were probably their oldest form, but by the middle of the thirteenth century the money raised by import and export (particularly the latter) duties was a substantial portion of the revenue of the Crown. It was just about a century later than this that the economic theory, loosely called *Mercantilism*, was rapidly gaining ground. Politically speaking, the epoch after the Reformation was one of intense national feeling; in England, for instance, we have the Elizabethan age—an era of glorious adventure and unbounded patriotism, when, too, some of the greatest literary productions in the world's history appeared. The theory of trade which men began to devise was also national; "it professed to be based on a regard for the commonwealth, and to seek the public good. Its acceptance as a public policy preceded its formulation as an economic theory, and the popularity of the theory, when put forth by Thomas Mun in 1664 [in his *England's Treasure by Foreign Trade*], was due in some degree to the fact that it seemed to give a scientific explanation of trading in accordance with the popular sentiment of the times."[1] Two of the most important tendencies of the mercantilist doctrine were to attribute great importance to a large supply of gold and silver and to consider foreign commerce

[1] Armitage-Smith, *Free Trade Movement*, p. 18.

more important than domestic trade. The result of this doctrine on the customs duties was natural enough; import duties were increased and exports encouraged (often by bounties). Probably Adam Smith's greatest claim to fame is the way in which —influenced by the Physiocrats[1]—he dealt with this "patriotic" theory of trade. It is hardly an exaggeration to say that since 1776, when the *Wealth of Nations* appeared, purely economic defences of mercantilism and the protectionist theory which developed from it are impossible;[2] there are, however, other factors than the purely economic one to be considered, and it was not until the reforms of Huskisson, Peel[3] and Gladstone that England definitely started on an era of free trade and customs duties were imposed only from financial considerations. To-day they are levied on just over a dozen articles, the most important being tobacco, tea and sugar. The first-named provides for about half the total customs receipts.

Let us now consider the incidence of customs duties. We can notice, in passing, that the general tendency everywhere has been to abolish export duties; in the case of England, all except the one on coal were done away with by Peel in 1842, and three years later this one also disappeared. It was imposed again from 1901 to 1906 at a rate of 1*s*. per

[1] A French School of economists among whom was Turgot, a minister of Louis XIV.

[2] *Cp*. Armitage-Smith, *op. cit.*, and Cunningham, *Rise and Decline of the Free Trade Movement*, or Ashley, *The Tariff Problem*, and Hobson, *International Trade*.

[3] Particularly the repeal of the Corn Laws, 1845.

ton. The incidence of an *export* duty is fairly simple. If a duty of, say, 2*d.* a yard was levied on all cotton goods exported, we can well suppose that the first thing a merchant exporting the taxed goods would do would be to raise the price by about 2*d.* per yard. Would the foreign merchant pay the extra 2*d.*? It is obvious that he would try to find another market which could supply him more cheaply, and unless the exporting country had an absolute monopoly of the cotton goods (which is very unlikely) its export trade would suffer a loss, unless the exporting merchants paid the duty themselves or, at any rate, were able to shift it on to some one else other than the foreign consumer. In the case of a monopoly, the demand for which is elastic, supposing that the exporting merchants have fixed the price at which they can obtain the maximum returns, then a tax would probably be included on *their* surplus. When the demand is not elastic—as, for instance, a few years ago in the case of South Wales coal—then a tax probably could be shifted on to the foreign consumer—for a while at any rate; but such a condition of affairs surely could not continue for very long. After all, the notion that one country can impose taxes on another in this way savours of Gilbertian humour.

Turning to *import* duties, somewhat the same considerations seem to hold here too. We have analysed income into costs and surplus, and shown that a tax must ultimately fall on a surplus however many times it may be shifted in the process of finding that surplus. Well then, the common idea that the foreigner can be made to pay the import duties rests on the assumption that he has a surplus in his income and is prepared to have that surplus taxed. If there was only one market for the goods which he must produce, and if that market imposed a tariff, then he might be made to pay—that is the simplest case, and has been discussed in books on political economy since the time of Adam Smith. But to-day, the modern conditions of mass production make a further examination of the problem necessary. An American trust, say, finds that its costs of production are relatively least when it is making a huge quantity of safety razors daily; these cannot all be put on the home market, and, at the same time, the price it requires kept up, so the possibility of "dumping" quantities of razors on the markets of another country might be tried. It is very probable that it will be prepared to sell them there at a lower rate than they fetch in U.S.A.[1] Can the country in which the goods are dumped place an import duty on them and "make the foreigner pay"? The *importing* merchant pays the tax and, supposing that he cannot bear it, will probably try to shift it on to the trust by declining to buy from them except at a reduced price, and, rather than this should happen, the exporting trust will endeavour to find another market for its goods. Even if that could not be

[1] It is obvious that there are two necessary conditions before "dumping" can take place; first, that the exporters are monopolists, and, second, that their own State is protectionist, or otherwise the dumped produce might be re-exported into their country.

done, it is still open to the manufacturers to lower their home prices and so enlarge the demand—or they might even slacken their rate of production. Anyhow, the net result is that little or no revenue is obtained from the tariff, and as a result of keeping the foreigner out, prices in the country will be raised. This, of course, is precisely what a good many protectionists wish to do. "Higher prices, higher wages, less unemployment," runs the argument; but the fallacy lies in looking at one particular industry (e.g., the safety razor one in the above example). If a wider and more reasonable outlook is made, it must be realized that trading includes both buying and selling, and the fundamental principle of international trade is that *exports* (including, of course, what Sir Robert Giffen calls the "invisible exports"—freight,[1] etc.) *are paid for by imports*, goods and services sent out of the country pay for goods and services received.

Thus the revenue gains from protective duties (with a few exceptions) are usually slight, while, on the other hand, a definite evil may be brought by their imposition. Incidentally, the two arguments that such duties can bring revenue and also "protect," surely cannot *both* be used. Revenue can only be obtained from duties which certainly are not protective; such are the tea, sugar and (to a certain extent) the tobacco duties in England. The German *Zollverein* and the suggested British

[1] As Mr. Hartley Withers puts it, "there are many more exports in heaven and earth than are dreamt of by the philosophy of the Board of Trade returns." *Meaning of Money*, p. 190.

Empire Customs Union may perhaps be the beginning of a new era, and some time in the distant future Mr. H. G. Wells' vision of the United States of the World may materialize, and customs duties and tariff wars be things of the past. Beautiful, however, as such ideals may be, they scarcely enter at present, I am afraid, into practical finance.

Appendix to Chapter IV

I

HISTORICAL NOTE ON THE CUSTOMS DUTIES OF THE UNITED STATES OF AMERICA

George Washington, first President of the United States, came into office on April 30, 1789, and he chose Alexander Hamilton as his Secretary of the Treasury. The financial situation which the first Congress had to face was far from pleasant, and to pay the interest on the debt contracted during the War of Independence, Hamilton levied customs duties on a large number of goods [1]—chiefly manufactured articles. The prices of goods naturally rose in the country, and the Southern States, where agriculture was the chief occupation, were loud in their opposition to the tariff. As a matter of fact, however, the duties were then literally protective and thriving native industries did begin to spring up in the North.

In 1812 there was a short war with England and the tariff rates were increased to provide revenue to carry on the fighting. In 1816, however, when peace had been restored in Europe and America, England, as a result of the industrial revolution, was producing manufactured goods on a large scale and, in order to keep these things out of the States, yet another tariff bill was passed,

[1] He also introduced so many indirect internal taxes that a member of Congress in 1790 said, " The time will come when the poor man will not be able to wash his shirt without paying a tax." Quoted by Seligman, *Essays in Taxation*, p. 8.

raising the average rate of duty up to about 20 per cent. Higher rates than ever were imposed in the course of the next eight years and afterwards the reaction set in. The chief occupation in the Southern States was then cotton growing, while the duties were raising the cost of living and "protecting" only the infant industries in the North. Then the political jobbers of the South hit upon an ingenious idea. A preposterous tariff bill was proposed *by them*—duties were increased, but on articles, too, which the North wanted cheaply—with the idea that it would seem so ridiculous to the northern party that it would be rejected and so discredit the previous work on the customs duties done by the President, Adams. Their plan was "defeated" and the "Tariff of Abominations" as it was called became law; the southern party were furious and in 1832, when another tariff bill was passed, South Carolina declared that if any attempt was made to force the new rates of import duties on the South she would secede from the Union. Civil war was avoided just then by another bill providing that the duty rates should gradually be reduced until, in ten years, they should be the same as they were in 1816.

The Civil War (1861–65) came, tariffs were increased once again and then, later, occurred the great financial panic of 1873, after which a period of prosperity began and in about ten years the revenue system was yielding a huge surplus of receipts over expenditure. Increased expenditure or redemption of the national debt did not appeal to President Cleveland (elected 1885) and he began his war on the tariffs. He was defeated; the Republicans and the trusts were too strong for him. In 1890 the McKinley Bill was passed—and also, incidentally, the Sherman Silver Bill which was repealed three years later—and duties on many articles suffered a further increase; but projects of reciprocity with the republics of South America began to be mooted.

In 1893 Grover Cleveland was again elected President and, although defeated previously on the tariff question, he once again moved to the attack. What is known as the Wilson-Gorman Tariff Bill to reduce the duties passed the House of Representatives, but had about six hundred amendments made to it in the Senate, with the result that there was little or no reduction in the duties—the bill was, in fact, almost a farce. Just as Peel had introduced an income tax in 1842 to compensate for the tariffs he had abolished, so also was a tax on income proposed at this time in the States. The Supreme Court, however, decided that it was illegal, and it was not until 1913 that an amendment to the Constitution gave Congress the power to levy an income tax. By the Dingley Act of 1897, duties were again increased, and now averaged about 60 per cent. on such articles as glass ware.[1]

President Roosevelt's attacks on the trusts, and the attempted reciprocity treaty with Canada bring us down almost to the problems of yesterday and to-day, and those we cannot discuss here.

II

THE AMERICAN CORPORATIONS TAX

We have pointed out in a previous chapter that the English property tax (the "fifteenths and tenths")

[1] An American writer says that "the present position of protection in the United States rests, however, less on reasoning than on sentiment and experience." Seager, *Introduction to Economics*, p. 379.

by the time of the Commonwealth was changed into a monthly assessment, the Restoration altered it into a land tax, and finally Pitt, in 1798 made it into a rent tax.

In the United States, however, a property tax has been used continuously since the first days of the New England Colonies. Noticing that a corporation or an incorporated company is a legal "person,"[1] we shall have no difficulty in extending a property tax to a tax on corporations. "The early tax laws made no mention of corporations. But as the general property tax was in vogue throughout all the commonwealth, it was tacitly assumed that the property of artificial as well as natural persons was liable."[2] The transition was easy enough; the difficulty arose when these early legislators left their posterity to "dig in" after they have captured the position. What should be the basis of a corporation tax; how should it be levied? These were questions which almost every State answered differently; thus there are at present three broad methods of levying a tax—on the property of a corporation, on its business, or on its earnings; but there are actually in use no less than thirteen different ways[3] of using the three bases—e.g., taking the property one, a tax can be levied on the value of the property, or on its cost, on the capital stock at par or at market value, on the capital stock plus bonded debt at market value, on the capital stock plus the total debt both funded and unfunded, on bonded debt

[1] But one who never dies and so could not be liable, in England, to death duties; hence an annual duty of 5 per cent. is charged on their annual net profits. The English Railway duty is a relic of the days when stage coaches were taxed; it has largely decreased in yield since the abolition of second-class fares on most lines.

[2] Seligman, *Essays in Taxation*, p. 145. I am indebted to chapters vi to vii for much of my material for this appendix.

[3] See list in Seligman, *op. cit.*, p. 219.

or loans, or on capital stock according to dividends. Again, in many States, numbers of different industrial concerns are specifically mentioned and taxed separately, e.g., grain elevators in North Dakota and gas companies in Texas—as Prof. Seligman remarks, the whole subject seems to be " involved in almost inextricable confusion."

The incidence of a corporation tax is an interesting puzzle, but we can only afford space to suggest the outline of a solution. It is a tax on business, but at the present time is levied only on one form of business organization and so, at first sight, it would seem to be unfair. We must, however, remember that in the United States, thanks to their commercial law, corporations are more numerous than they are in most other countries. Usually it is assumed that a corporation tax would be incident on the shareholders (or bond-holders). But if only corporate securities are taxed, then it is obvious that a purchaser after the tax has been imposed would pay less for them; the price of the taxed stock would fall and really the only person to bear the tax would be the original investor, who perhaps purchased the stock before the tax was levied. On the other hand, if *all* securities were taxed, i.e., a general company tax levied—and if also there was an income tax, this probably would involve double taxation, it means then that the investor would be twice taxed.[1]

[1] A modern example of curious taxing practice is afforded by the State of Mexico. In September, 1921, was the centenary of its independence, and to " celebrate " the occasion a special tax was imposed, to be paid only once and based on incomes earned during the month of August. The tax was graduated; thus incomes less than $100 per month were exempt, workmen paid 1 per cent. on incomes up to $250 a month and business men paid 1 per cent. on incomes up to $300 and up to 4 per cent. when their earnings exceeded $1,000. The money raised by this tax is to be used to develop ports and a mercantile marine.

BALANCE SHEET ESTIMATES, 1921–1922.

ORDINARY RECEIPTS.

Tax Revenue.

	£
Customs	126,800,000
Excise	196,200,000
	323,000,000
Motor Tax	9,000,000
Estate, etc., Duties	48,000,000
Stamp Duties	21,000,000
Land Tax and House Duty	2,500,000
Income Tax (including Super-Tax and Mineral Rights Duty)	410,500,000
Excess Profits Duty	120,000,000
Corporation Profits Tax	30,000,000
Total Tax Revenue	632,000,000
Non-Tax Revenue.	
Post Office	60,000,000
Crown Lands	650,000
Receipts from Sundry Loans	12,000,000
Miscellaneous Receipts	21,500,000
Total	£1,058,150,000

ORDINARY EXPENDITURE.

Consolidated Fund Services.

	£
National Debt Services	345,000,000
Road Fund	8,400,000
Payments to Local Taxation Accounts	11,115,000
Land Settlement	5,000,000
Other Consolidated Fund Services	1,757,000
Total Consolidated Fund Services	371,272,000
Supply Services.	
Army	95,963,000
Navy	80,479 000
Air Force	16,940,000
Civil Services	327,503,000
Inland Revenue, etc., Departments	14,701,000
Post Office Services	67,165,000
Total Supply Services	602,751,000
Total Expenditure	974,023,000
Surplus	84,127,000
Total	£1,058,150,000

Note.—This year a distinction was made between "ordinary" and "extraordinary" receipts and expenditure. The latter refer to the realization and liquidation of War assets and liabilities and is not given here. See *Treasury White Paper* 89.

CHAPTER V

THE FINANCE ACCOUNTS OF THE UNITED KINGDOM

1. Expenditure.—In this chapter we will touch upon a few important points in the actual working of the finance of the United Kingdom. What is called our financial year lasts from April 1 to the following March 31 (since 1854), and at the beginning of the year the Chancellor of the Exchequer presents to Parliament his estimates of the expenditure and income and how he proposes to raise the revenue for the coming period.

Estimates of their expenses are prepared in the first place by each of the spending departments; these are then submitted to the Treasury, where they are scrutinized and the reasons, in particular, for any novel items examined, and it is these collected estimates that are presented in the Budget[1] speech. Of course, at first sight, it might appear that accurate estimates would not be possible, but we must remember (especially in connection with the estimates of revenue) that the modern finance minister

[1] This word is derived from the French *bougette*, meaning the bag in which the Chancellor of the Exchequer carries the notes, etc., for his speech.

has at his disposal a vast quantity of all kinds of financial statistics, and from these it is generally possible to make a pretty fair calculation of what the expenditure (and income) for the coming year will be. Abnormal events such as large industrial disputes will upset the year's estimates, and then it is usual to request for *Supplementary Votes* of money from Parliament.

The estimated expenditure for 1921–1922 is given in the table on p. 74. The account is divided into two parts, the votes for the Consolidated Fund Services and for the Supply Services; the former are fixed permanently by Special Acts of Parliament, while the latter are debated and voted annually when the House goes into Committee of Supply. The National Debt Services, the most important item among the Consolidated Fund charges, and the payments to Local Taxation Accounts we will deal with in the next two chapters. The Road Improvement Fund was started in 1909 to make grants and loans for the construction and repair of roads throughout the country. The greater part of its funds are allotted to it from the motor spirit tax imposed by the 1909 Budget and the carriage, etc., licences. The most important items among the "Other Consolidated Fund Services" are the Civil List and a number of salaries and pensions. The former is the annual amount voted to the Sovereign on his accession; from 1760, when George III came to the throne, the Sovereign has surrendered his income from the Crown lands, and in return has this definite sum for his expenses.

Various public officers, like the Speaker, the Auditor-General, the Comptroller-General and the judges, have their salaries paid to them out of the Consolidated Fund in order to make them more independent of the executive.

The Supply Services include the separate votes allotted to the Army, Navy, Air Force, the various departments of the Civil Service, the Revenue Departments, and the Post Office Services.

2. REVENUE.—The estimated revenue for the year 1921–1922 is set out under its various heads and the two divisions into tax and non-tax revenue on p. 74. The receipts from Sundry Loans include the dividends on the Suez Canal Shares and repayments of loans to a number of colonial and foreign governments; the Miscellaneous Receipts include the excess of receipts over expenditure in the working of the Mint and a number of other small items. Notice these are only the *estimated* receipts; the actual money paid into the Exchequer (or the government accounts at the Bank of England and the Bank of Ireland) will not be equal to these amounts for two reasons—first, because only round sums are paid into the Exchequer, and that paid in in any given year includes arrears from the previous year's working; and second, because of what are called *Appropriations in Aid*, which, in brief, are the comparatively small amounts received from a large number of sources—e.g., the entrance fees for visiting the Tower—and which, instead of being paid into the Exchequer, are used to defray a number of working expenses.

3. The Voting of the Budget, its Control and Audit.—Following the presentation of the Chancellor of the Exchequer's Budget statement, the whole House of Commons sits as a committee [1] before passing the definite legislative act which imposes the taxes for the following year, and at this point we may conveniently notice the development of our present system of parliamentary control of taxation. It falls into two distinct periods—first, the struggle between the king and the parliament to obtain the control of taxation, and second, the conflict between the two Houses of Parliament.

On June 15, 1215, King John sealed *Magna Charta*, and its thirty-second article was that "no scutage or aid shall be imposed in our realm save by the common council of the realm"; in 1297, Edward I agreed to the *Confirmatio Cartarum*, the confirmation of the great charter, but in 1304 he levied tallage, this form of taxation not being expressly mentioned in the charter. However, in 1340, Edward III was quite willing to give up his right of levying tallage and received in return a subsidy from Parliament to carry on his war in France. Thus Parliamentary control over direct taxation was established and before the end of the century the control of indirect taxation—particularly the customs duties—was also obtained. In 1606 James I increased the customs duties, Parlia-

[1] In the Committee of Supply, sums necessary to defray the various charges are voted, while in the Committee of Ways and Means the way in which the money shall be raised is discussed. Finally, the raising and spending of money is authorized by an Appropriation Act.

ment protested and he dismissed them. Money was not forthcoming to help his poor Exchequer, so the hereditary title of knight baronet was invented and given to gentlemen who would lend the king £1,000. Charles I persisted in levying taxes without the consent of Parliament, and this was one of the root causes of the Civil War. However, after the bloodless revolution of 1688, we can say that parliamentary control was firmly established. When we come to the second stage of the struggle there seems, first of all, to be an *a priori* argument that only one House should vote money bills. On obtaining money by taxation the whole machinery of government depends; if it can only be raised or spent by legislative acts, and none of these are forthcoming, or if they are delayed, the machinery will have to stop. This can surely be averted by making one House responsible for finance bills and justice seems to point to the one which is elected by the people. This at any rate was the "custom of the constitution" with occasional breaks[1] from the beginning of the fifteenth century, until, by the *Parliament Act* of 1911[2] it was defin-

[1] Thus in 1904 when the House of Lords amended the Licensing Bill.

[2] The first clause of this Act reads, "If a Money Bill having been passed by the House of Commons and sent up to the House of Lords at least one month before the end of the session is not passed by the House of Lords without amendment within one month after it is so sent up to the House, the Bill shall (unless the House of Commons direct to the contrary) be presented to His Majesty and become an Act on the Royal Assent being signified, notwithstanding that the House of Lords have not consented to the Bill." In this year, owing to the pressure of other business, the Budget had to be postponed to the autumn session.

itely legislated that the House of Lords could neither reject or amend any money bills. The Speaker endorses such bills to this effect when they have passed the Commons. Another custom in connection with finance bills is that they should always be proposed by the Crown through one of its ministers. This is an important check, as the executive which proposes spending must also raise the money to be expended.

Following the voting of money by Parliament there still remains the checks and audit of its expenditure. When a department requires money a request has to be made through the Treasury (since 1866) to the *Comptroller-General*, who examines the reason given for the money required and sees if it is in accordance with the Act of Parliament sanctioning the expenditure of this particular vote which is being drawn upon. If everything is satisfactory, he signs an indent on the Exchequer, and the money is paid into the supply account of the Paymaster-General, from which it can be drawn upon by the department. As Prof. Bastable puts it, "the Bank of England is the sole receptacle for collected revenue, and the Comptroller's order the only key that unlocks its coffers."[1] The accounts of the spending departments are examined by the Auditor-General, who notes if the money which has been obtained has been spent for the alleged purpose, and presents a report to the *Committee of Public Accounts*. We may just notice, in passing, the effect of tax payments on the money

[1] *Public Finance*, p. 758.

market. Although payments into and from the Government account at the Bank of England are made throughout the year, during the March quarter exceptionally large amounts come in through the receipts, in particular, of the income tax and the inhabited house duty. Thus money in the outside market naturally becomes scarce, but in consequence of this large increase in Public Deposits the Bank is able to replenish its reserve and to regulate the credit which is based on that reserve.

The " budgets " in local finance are rather differently worked. The first local tax to be considered is the poor rate, which has been worked out by the overseer of the poor ; [1] estimates of income and expenditure are prepared by the various sub-committees, e.g., the education committee in a borough and presented to the finance committee. To collect the money required very often a consolidated rate is levied upon all the rates for different purposes. There is, too, a certain amount of variety in the method of auditing employed. The district auditor of the Ministry of Health can audit the whole of the accounts of, say, a borough, but he must do this for the education and unemployed accounts, and two elective auditors, with or without the help of a professional auditor, can do the rest. Any burgess can inspect the borough treasurer's accounts.

[1] See later, Chapter VII, Section 1.

CHAPTER VI

PUBLIC CREDIT

1. THE NATIONAL DEBT.—In the last chapter we have mentioned the Consolidated Fund and noticed that the greater part of the expenses under this head are for the National Debt Services; we will now go rather more into details of the National Debt and public credit in general.

In our short survey of the development of our taxing system we saw that originally the hereditary revenue of the Crown sufficed to meet all ordinary expenditure. When this ceased to be possible, taxes voted by Parliament were next employed, but even money thus obtained soon proved to be insufficient to meet extraordinary charges—the most important of which were the costs of wars—and to raise money for this purpose, resort was soon made to *loans*; money was borrowed at first on the security and in anticipation of the revenue obtained from certain specific taxes. *Forced loans* were also raised by some kings, and Henry VII, ably assisted by his minister Cardinal Morton, revived the old system of Benevolences or gifts to the crown. Thus it was that up to 1672 the goldsmiths of

London, the bankers of that time, had advanced £1,300,000 to Charles II. The panic came when, in that year, he found it convenient to "stop the Exchequer," and refused to repay the capital of the loan.

Our word "credit" is derived from the Latin *credo* (I believe), and since the end of the sixteenth century our commerce has been built up on the credit system. Money was being used less and less, and credit instruments became the chief method of making payments; the heyday of mercantilism and its bullion transactions was quickly drawing to a close. The need, however, of an efficient and reliable system of banking was soon felt, and from about the time of the Restoration a number of schemes were suggested. Finally, in 1694, the Bank of England was established. But it "owed its charter less to a deliberate cognizance by the Government of the services which such an institution could perform to the business world than to pressing necessities of State."[1] The finances of the government were in low water; £1,200,000 was required urgently, and thus it was William Paterson's scheme was accepted. He agreed to collect this amount of money, and to lend it to the State at eight per cent., plus £4,000 a year as the expenses of management, and a Charter authorizing, amongst other privileges, the "Governor and Company of the Bank of England" to issue bank-notes up to the amount of the £1,200,000 lent. Thus we reach the origin of our regular National

[1] Meredith, *Economic History of England*, p. 223.

Debt.[1] The expenses of William III's war with Louis XIV of France began to increase it immediately, and in 1702, when Anne came to the throne, it already stood at £16,400,000.

It seems almost absurd to ask if loans are economic ways of returning money. They have constantly been employed to cover what is called "extraordinary expenditure," expenditure which has, however, to be met somehow or other and which is, by hypothesis, too great a strain to put all at once on the sources of taxation. Notice that also in the case of war expenditure money is required at once, whereas that obtained by taxation only comes in gradually. The cost of a war,[2] however, can be met to a certain extent by increased taxation—the Income Tax has become a powerful instrument for this purpose—and we must remember that loans in general must be redeemed eventually by the revenue obtained by taxation or, supposing that they are *not* redeemed, then they are all the while a permanent charge on the revenue.

Another fairly frequent purpose of government loans is to make up a deficiency in the current year's revenue receipts, but we will mention this use again a little later. Loans can also be made

[1] Bagehot, *Lombard Street*, ch. 3, says, "The origin of the Bank of England has been told by Macaulay, and it is never wise for an ordinary writer to tell again what he has told so very much better."

[2] As an example of the survival of the mediæval system of a State hoarding treasure to meet the cost of a war, we may note the case of the Germans storing £6,000,000 of bullion, part of the French indemnity after 1870, in the castle at Spandau. (See Bastable, *op. cit.*, p. 615.)

by Local Authorities,[1] but we find that in most cases local indebtedness is incurred chiefly to establish public buildings (e.g., libraries, parks and town halls) or for "reproductive" services (e.g., the water supply or the tramways), and in most of these cases there seems to be no other way of raising money; here, again, it is required immediately, and further, since future generations will have the benefit of, say, a park, it is only just that they should contribute to its cost. Generally, however, proposed expenditure for reproductive services will need a good deal of forethought, and in many cases the extremely controversial subject of municipal trading will arise.

A way in which a government can obtain what amounts to a forced loan may be mentioned at this point. It can, in effect, get a "loan" without interest by the issue of an inconvertible currency. The old school of economists was very severe on this device; certainly its economic effects may be considerable—gold prices will rise, and if the paper notes should be over-issued, their values depreciate still further and eventually a return to gold payments (if desirable) is made more and more difficult.

Government loans are usually of one of two classes, *Funded Loans* or *Unfunded* (or *Floating*) *Loans*. The former are perpetual debts upon which the

[1] Within prescribed limits. Thus borough loans must be repaid in thirty years. A recent development is that Local Authorities can now borrow fifty per cent. of the total sales of National Savings Certificates in their areas for any purposes for which the Public Works Loan Commissioners have power to lend.

government undertakes to pay interest, but no date for repayment is promised in most cases. Such a loan is called Funded Debt because it is a charge on the revenue fund of the country; in England the more familiar name of *Consols* dates from the time when Henry Pelham, in 1752, consolidated a number of different loans into one class of 3 per cent. stock. The bulk of the English National Debt in 1914 was comprised of Funded Debt.

Unfunded Debt, on the other hand, consists of temporary loans repayable on fixed dates—e.g., Treasury Bills, and National Savings Certificates. The Exchequer has a large number of payments to make throughout the year, while the revenue from taxation comes in slowly—or there may even be a deficit—and a temporary loan is issued to enable all the charges to be met when they are wanted. It is obvious that a good financial maxim is to keep the floating debt as small as possible.

It must be remembered that when a government wishes to borrow money it must enter the money market and issue its prospectus in exactly the same way as would an industrial concern. The conditions of issue of any particular loan—whether it is to be at par or not—will depend to a large extent upon the state of the money market at the time[1] and the same holds good for any methods of redemption which may afterwards be applied.

2. THE REDUCTION OF DEBT.—Before coming

[1] See note on p. 92.

to the methods available for the reduction of the National Debt it will not be out of place to ask first of all if it is desirable that it should be reduced below a certain figure. Surplus revenue can obviously be applied to redeem an equal amount of debt; but if there is a surplus of receipts on expenditure it shows that taxation might be reduced. In general, a loan is voluntarily raised from capital, whereas taxation is a deduction from income. Income and capital cannot definitely be separated, the first is a source of the second, and if this source were less heavily tapped by taxation, then it follows that within limits capital would have a better chance of accumulating. Government debt to-day is also a safe and convenient investment for many people who do not care to speculate or invest in industrials.[1] Thus, if there is a surplus in the year's revenue, provided that conditions in the country are normal, it might well be prudent to revise the rates of taxation or abolish some comparatively unsound tax.

Of course it might be perfectly *legal* for a State to repudiate its national debt, but such an action, besides being immoral, would most certainly make any future borrowing very difficult indeed. Then again, another obvious method would be for the

[1] See p. 70 for what happened in the United States when this occurred. Then the possibility of reducing the National Debt was complicated by the creation of the banking system in 1863, when banks were allowed to issue notes up to the value of 90 per cent. of the government bonds which they had bought and deposited at Washington. A reduction of the debt would thus, if no other changes were made, mean a reduction in the circulation of these notes—which was highly undesirable.

Chancellor of the Exchequer to buy in the market any government stock which is below par and cancel it; this is actually done, and the effect is to increase the price of the stock, and when this happens another method can be used.

Let us now deal with the three most important methods. The first depends on the fact mentioned above that debt can only be repaid from the revenue and consists in applying any surplus revenue for that purpose. This has been done in England at various times since 1716, and before the late war there were the *Old* and the *New Sinking Funds.* In the former was placed any revenue surplus to the year's expenditure, while at the same time a definite sum was voted annually for the National Debt services and any surplus, after the interest of various annuities and charges had been paid from it, placed in the latter fund and used to redeem a portion of the principal of the debt. Needless to say, the New Sinking Fund was suspended during the war.

A second method is that of *conversion*, which simply means converting stock paying a certain rate of interest to stock paying a lower rate. If loanable capital is plentiful, then a loan for which the Exchequer has been paying 5 per cent. may perhaps be got for $3\frac{1}{2}$, and naturally a wise Chancellor will try to get it at the lower rate by offering $3\frac{1}{2}$ per cent. to the lenders instead of the 5 they had previously been getting or, if they refuse, he can repay their principal. Such a course may not, of course, be popular with the fundholders and in order to attract them a nominal increase in their principal may be offered to them, thus, at first sight, making an addition to the burden of the total debt —but it may, all the same, be advantageous to the Exchequer, as we shall see in a moment. Conversions have taken place a number of times since 1716; the most recent was announced in the Budget Speech of April 25, 1921. In this case the object was "to prevent £632,000,000 of National War Bonds maturing in the next four and a half years from being added to the floating debt."[1] Seven different series of War Bonds are involved in the offer; the owner of, say, £100 5 per cent. National War Bonds maturing on October 1, 1922, was offered £163 of 3½ per cent. Conversion Loan, while the Exchequer gains to the extent that a large amount of floating debt can be made into funded debt which will not be redeemable before 1961.

A third method consists in the use of *terminable annuities* by which permanent is changed into temporary debt. An annuity can be purchased at a Post Office from the National Debt Commissioners for a definite sum, say £1,000; what it amounts to is that you buy £1,000 worth of the National Debt which pays you interest for a definite time, e.g., ten years or for a lifetime. The rate of interest it pays is, of course, higher than if it had remained in the debt, but when the annuity expires—which it may do in ten years or when you die—£1,000 of the National Debt has been redeemed.

[1] *The Times*, April 26th, 1921.

Finally, we may mention the method of reducing the debt by a levy on capital, or alternatively, a levy on war wealth. Lately the subject has been very prominent because of the enormous increase in the National Debt caused by the late war, and no other branch of public finance is giving the academic economists such a delightful field of speculation! Ricardo and Mill long ago discussed the possibility of reducing the debt by a general contribution from *property*, and the latter agrees that it would be incomparably the best way "if it were practicable."[1]

To-day, the question turns on whether we shall pay interest on about 6,000 million pounds (the gross capital liability of the State) and establish a sinking fund to pay off some of the principal each year or else, by means of a capital levy, pay off at once a large portion of the debt. We must separate the two aspects of the subject—the theoretical and the practical. Put very briefly, the most important economic (and ethic, for that matter) arguments used to advocate such a levy are, first, that as government borrowing during the war had to be made at high and "artificial" rates of interest, the paying off of a large amount of the principal would help to lower the general rate of interest and cause pre-war investments to rise in value. Although, as we have pointed out in an earlier chapter, a certain rate of interest is a necessary "cost" in production, yet if money is too dear (as the phrase goes), the effective demand for it may be lowered

[1] *Principles of Political Economy*, Bk. V, ch. vii, p. 2.

for a time.[1] Second, the war loans were raised when the currency was inflated, and the purchasing power of money low; if the debt is not soon redeemed, the *real wealth* which will eventually have to be paid back—and of course the annual interest until that time—will be much greater than when borrowed—e.g., £100 lent in 1917 would then scarcely buy a motor cycle and sidecar; in six years' time, say, if the £100 is then repaid and, as is apparent, prices are falling, it will certainly buy the machine, and a good many tins of petrol in addition—very nice, of course, for the receiver of the £100, but hardly so for the Chancellor of the Exchequer. Third, there is the disastrous effect on work and saving of a high rate of taxation (particularly in the case of an income tax), which it will presumably be necessary to levy to pay the interest on the unredeemed debt.

On the other hand, we may notice particularly that (the orthodox method of discharging the debt being by a sinking fund) as the abnormally high rate of interest is lowered, conversions will be possible and also that an income tax probably will yield increasing amounts of wealth in each successive year, owing to the growing number of incomes on which it can be levied.

Lastly, there is the practical side of the question—the basis of assessment for a levy and the method of paying it. Here the issue between a general levy on capital and just a levy on war wealth is

[1] E.g., we often hear that housing schemes are too expensive nowadays—but we must, however, remember the other factors in production.

most marked. The latter would involve two assessments and the former only one; two would undoubtedly be difficult, but the argument that even one would lead to a great deal of evasion seems, on examination, to be weak; such estimates are made at present by executors for the levying of the inheritance taxes, the Probate and Estate Duties. Further, we have an example in Germany —two levies have already been made there, in 1914 and 1917.

Note.—There are in general two distinct methods of negotiating a loan—either by issuing it at a fixed price and at a fixed rate of interest, as is done in the case of the various issues of Treasury Bonds, or by inviting tenders for certain amounts, as is done in the case of Treasury Bills.

CHAPTER VII

LOCAL TAXATION

1. The Principles and Incidence of Local Taxation.—It remains for us in this last chapter to devote some consideration to local taxation. Money is, of course, required by local authorities, and we can distinguish two normal sources of local revenue :—

1. Local taxation.
2. Contributions from the central government.

We will deal with these in turn. A glance at the various heads under which revenue is obtained by the central government will show that a number of taxes are obviously unsuitable for local application. Customs and excise, for instance, could hardly be used locally in England; a system of local tariffs would be costly in collection and uneconomical. In France and parts of Germany and Italy, as a matter of fact, local customs duties called *octroi* are levied—in 1896 there were no less than 1,513 French towns using this system, and so raising about a third of their total revenue—the chief articles which were taxed being wines, beer, oil, meat and building materials.[1] Similarly income

[1] Leacock, *Elements of Political Science*, p. 324. *Octroi* are, however, disappearing.

and personal property taxes are almost out of the question, for the simple reason that income cannot be localized. As Lord Goschen put it in his *Local Taxation*, "It appears to me impossible to devise an equitable local income tax, for you cannot possibly localize income. An attempt was made in Scotland, and it broke down when an English Lord Chancellor, who drew his £10,000 a year in London, but had a small place in Scotland, was made to pay income tax on the whole of his income in that country as well."[1]

But, on the other hand, as local expenditure is for the benefit *primarily*[2] of the local inhabitants, a reasonable way of obtaining their contributions would be to levy a tax in proportion to the real property (land and houses) which each possesses, and which local expenditure may, in the first place, be considered as benefiting. Landowners generally derive most lasting advantage from local enterprise, while householders and tradesmen with business premises get the advantage of improved roads, drainage, sanitation, and many other items of local expenditure. This method of "rating" land and houses according to their assessed rental value is indeed the one employed for raising local revenue. Notice the method of assessment. In England it is based on the rental value, and it is obviously possible that large non-rented estates which are often kept chiefly for pleasure purposes, might either not be rated at all or else pay a ridiculously

[1] Quoted by Bastable, *op. cit.*, p. 395.
[2] See, however, the second section of this Chapter.

inadequate amount compared with their ability to pay. The four land taxes introduced in the Budget of 1909 were an attempt to remedy this injustice. "Land in the United States is taxable at its *selling value*; and if the land rises in value as population increases, the landowner must still bear his proportion of the local burdens, even though the land remains vacant or is used for agricultural purposes."[1] This method of assessment seems to have many points in its favour, but unfortunately its use for the general property tax employed in the States for both state and local taxation is far from being just. Use is also made in the United States of what are known as *special assessments*; property which has increased in value by reason of local expenditure has its additional value assessed and the owner charged a capital sum for the increase in value; as a matter of fact, however, the sum can also be paid in instalments if desired.

Another form of local taxation which is used in England is that imposed by certain licences; those known as *establishment licences*, and also the ones for dogs, game and guns have been collected through the post offices by the local authorities since 1909.

Turning for a moment to the administration of local finance, for the purposes of rating, say, a borough, the *Overseer of the Poor* and his *Assistant Overseer* prepare a Poor Rate Valuation list showing the rateable value of all property in their area; this list is public and appeals against any supposed unfairness can be lodged with the Assessment

[1] Seligman, *Essays in Taxation*, p. 488.

Committee and will be heard by them. This poor rate valuation list is the basis for the other rates levied, such as the general district rate.

Bearing in mind that rates are only a variety of tax and remembering the general principles of tax incidence, there should be little difficulty in following the incidence of rates. As in the case of taxes, let us take several typical cases. First, let us take the case of land on which a building has been erected. The rent paid to the landlord may in general be divided into two parts—the rent of the building and the rent of the ground on which it stands—and for a given house the latter will vary with the situation and, theoretically, would become nil on what is called the margin of building. On the other hand, the rent of the house is the annual value of the capitalized expense of production and management of the building and, if it was reduced, building operations would be discouraged. Now rates are levied at so much in the £ on the annual assessed value of the property, which consists of site and house; the occupier will pay the amount proportioned to the rent of the building—he is the "consumer" of the house—for the builder (or owner) would have no inducement to continue building if he had to pay the tax and could not shift it on to the lessor. On the other hand, the tenant would not pay the proportion of the rates charged on the ground rent, for that rent is determined by the demand for building ground and the available supply of suitable ground (or of land at present put to other uses but which might be suitable), and probably the highest price is already being paid for this particular piece of land ; supply and demand being unaltered, the value of the site remains the same and the landlord will have to pay the rates proportioned to the ground rent he receives. Thus the amounts of the rates paid by the tenant and the landlord are in proportion to the amounts paid for the house and the site in the total rent charged. Of course this argument assumes that the demand for houses remains the same whatever the rates payable may be ; as a fact, although a house of some kind is a necessity, the demand is probably not quite inelastic and the tenant may be able to shift some of the amount he has to pay on to the surplus in the landlord's ground rent. Another point to notice is that where the rates vary (e.g., increase), the brunt has usually to be borne by the tenant until his lease expires.

In the case of trade premises, the rates ultimately incident on the trader must be considered by him as an addition to his expenses of production and they will tend to be shifted on to the price of the goods he produces or sells. It follows from this that high local rates may cause a manufacturer to look for a more suitable locality for his works if the goods he makes are sold under highly competitive conditions.

Finally, let us take the case of agricultural land. Here the incidence of the rates is on the rent, but, as a general rule, when the rates are high the agricultural rent will be low. The incidence could not fall on the doses of capital applied to the land, or we might be sure that capital would seek more fruitful uses; and similarly it cannot be shifted on to the corn produced, for the competitors in the market will include those from less heavily rated farms. Still, if during a lease of a given number of years the rates of the neighbourhood increase, then the burden for the time being must fall on the farmer; inertia causes readjustments to be slow.

2. GRANTS IN AID.—The principle of English local government is that "every local body may exercise only those specified powers bestowed on it either by the legislative enactment by which it was constituted, or by general Acts of Parliament applying to all authorities of a certain class, or by special Local Act,"[1] and along with, and as part of, the control by the central government there has been since 1833 a transference of a portion of the imperial revenue to help cover the cost of local administration. An important point to bear in mind in this connection is that although an improved road, say, may be of most importance to those people whose business premises or houses are on a particular thoroughfare, yet important communications are also of national importance. The same idea applies to many different kinds of local enterprise; moreover, it *is* the local developments which make possible the presence of a taxable surplus in the incomes of a large number of citizens. Two results follow, as it were, from this point: first, it is perfectly logical that the central government should contribute towards local expenditure—

[1] Watson Grice, *National and Local Finance*, p. 7.

to give *Grants in Aid* as they are sometimes called; and second, that it has also a perfect right to superintend and keep a close check on local expenditure.

At this point we can distinguish four important reasons for grants in aid [1]:—

1. To prevent an extreme inequality of burden between one district and another.
2. To give weight to the suggestions, criticism and authoritative instructions by which the central government seeks to secure greater efficiency and economizing of administration.
3. They are the only method of bringing upon local administration the wisdom of experience of the central government as compared with the administrators of any small town.
4. They are the only way to force on all local authorities that "national minimum" of efficiency in local sources which we now see to be indispensable in the national interest.

As a help towards an appreciation of the situation at the present time, a short historical summary of the relations between national and local finance may be useful. One of the most important acts passed by the parliament which met after the first Reform Bill had been placed on the statute book was the Poor Law Amendment Act of 1834. For the first time in the history of English local government was "established the principle of compelling local autonomy to yield to central control." [2] It was then that parishes were grouped into unions and Union

[1] See Sidney Webb, *Grants in Aid*, chap. 2.
[2] Watson Grice, *op. cit.*, p. 62.

*

workhouses established, but, as yet, no grant was made by the national government. In 1833 the first education grant was given; it only amounted, however, to £20,000. In the next year a Select Committee on county rates was set up and following their recommendations, a grant was made from the Consolidated Fund in 1835 to cover a portion of the expenses of criminal prosecutions and prisons. In 1846, following the abolition of the Corn Laws, the first Poor Law Grants were made. It is interesting to notice the attitude of the various parties in parliament at this time; the landowner and agricultural class were concerned to have some relief from the increasing burdens of local taxation which were falling heavily upon them. This was one of Peel's arguments for increasing the grants, and Disraeli moved to the attack on the same lines in 1849 and 1850. Ten years later the question of rating government property arose and a grant of £35,000 was made in lieu of rates; this was followed in 1872 by grants for the upkeep of the police force (a grant for the Metropolitan force had been made in 1829) and pauper lunatics.

By far the most important landmark in the relations so far of central and local finance resulted from Mr. Goschen's first Budget and the Local Government Act of 1888. The chief provision of this Act was to discontinue grants in aid except for education and to assign in their places the returns from definite sources of revenue, e.g., half the probate duty. A Local Taxation Account was started into which the assigned returns were paid as they were collected. County and county borough councils, too, first came into existence as a result of this Act. Two years later a part of the excise duties on beer and spirits was assigned to local authorities. This system is continued substantially down to the present day with the exception that by the Finance Acts of 1907 and 1908, the earmarked returns were paid into the Exchequer and the collection and levying of a number of licences were left to the local powers.

In 1896, the Agricultural Rates Act provided grants of one-half of the rates paid at that time on agricultural land;[1] while finally it must be noted the Old Age Pensions Act of 1908 and the National Insurance Acts of 1911 to 1920 transfer the cost of a good deal of poor relief to the central government.

3. THE FUTURE.—A writer has described the present relations between national and local finance as being chaotic. I have tried to show the chief steps in the evolution of the financial relations between the two, and when it is realized that local government—as we know it to-day—is less than a hundred years old, it behoves us to take rather a more hopeful view of the relations in the future. The question which will soon be acute seems to be whether, seeing that local expenditure is undoubtedly growing, local taxation or grants must be

[1] Thus there are now the following grants:—

1. Probate Duty Grant.
2. Excise Duty Grant.
3. Licences Duty Grant.
4. Agricultural Rates Grant.

increased to provide the necessary income. On the other hand, our present system of local rating is a definite single tax and must necessarily have the defects of that form of taxation; it is becoming more and more obvious that *income cannot be localized*, and any tax system based on the principle that it is more or less localized will be seen to be inadequate. On the other hand, it is equally certain that our present system of imperial taxation is approaching a moderately ideal one—there are imperfections, no doubt, but taking the system as a whole it cannot be called unjust or unscientific. These considerations would seem to imply that local authorities must, in the future, depend more and more on grants. But the golden mean between local autonomy and bureaucratic control by the national government needs to be kept, and here, at the end of this little book, as in its preface, may I urge that the first and most important step towards securing that ideal is an educated public opinion, enlightened ideals of civic responsibility and a proper sense of public rights and duties.

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CHAPTER VII

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Grice, *National and Local Finance.*
Redlich and Hirst, *Local Government.*
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INDEX

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